TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 379

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 19, 1935

CERTIORARI GRANTED OCTOBER 14, 1935

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 379

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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Docket No. 6989

SAN JOAQUIN FRUIT & INVESTMENT CO.,
(formerly San Joaquin Fruit Co.),
Tustin, California,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPEARANCES

For Taxpayers:

GEO. M. NAUS, Esq.,
M. L. McLAREN, C. P. A.,
F. O. GRAVES, Esq.,
J. ROBT. SHERROD, Esq.,
JOSEPH D. PEELER, Esq.,
DANA LATHAM, Esq.

For Commissioner:

JOHN D. FOLEY, Esq.,
A. H. MURRAY, Esq.,
A. H. PIERCE, Esq.,
LLOYD CREASON, Esq.,
J. R. JOHNSTON, Esq.

DOCKET ENTRIES

1925

Sept. 10—Petition received and filed.
" 14—Copy of petition served on solicitor.
" 14—Notification of receipt mailed taxpayer.

1925

Oct. 1—Answer filed by solicitor.

" 20—Copy of answer served on taxpayer—assigned to Field Calendar.

1927

Feb. 25—Hearing date set 5-3-27. Los Angeles, Calif.

Mar. 30—Application for subpoena filed by taxpayer.

May 2—Hearing had before Mr. Marquette. Continued to reserve calendar.

" 2—Order continuing proceeding to reserve calendar, signed and filed. Both sides notified.

" 25—Transcript of hearing of May 3, 1927 filed.

1928

Apr. 4—Motion to amend petition filed by taxpayer, amendment tendered.

" 5—Motion granted.

" 10—Order placing proceeding on General Calendar entered.

" 9—Copy of motion and amended petition served on G. C.

June 8—Motion for extension of time to July 8, 1928 to answer, filed by G. C. Granted.

" 27—Hearing date set September 19, 1928.

July 9—Answer to amend petition filed by G. C. Copy served July 18, 1928.

" 31—Motion to consolidate with dockets Nos. 6988 and 20801 for hearing at San Francisco, California filed by taxpayer. (See 6988)

1928

Aug. 2—Hearing date set on motion August 15, 1928.

" 3—Copy of motion served on General Counsel.

" 15—Hearing had before Mr. Sternhagen on motion to place on Circuit Calendar; withdrawn. Continued to October 16, 1928.

" 15—Order consolidating this docket with 6988 and 20801 and continuing to Day Calendar of October 16, 1928 entered. (See Docket No. 6988)

Sept. 27—Application for subpoena duces tecum filed by taxpayer. (See 6988) [1*]

Oct. 1—Subpoena duces tecum issued. October 4, 1928 Subpoena served.

" 1—Order on application for subpoena duces tecum entered.

" 16—Hearing had before Mr. Murdock on merits. Submitted. Briefs due December 15, 1928.

Nov. 13—Transcript of hearing of October 16, 1928 filed.

Dec. 15—Brief filed by taxpayer. (See 6988)

" 17—Motion for extension to January 14, 1929, to file brief, filed by General Counsel. (See 6988) Granted December 18, 1928.

*Page numbering appearing at the foot of page of original certified Transcript of Record.

1929

Jan. 14—Brief filed by General Counsel.

June 29—Decision entered—B. H. Littleton. Division 4.

June 29—Opinion rendered. John E. Murdock, Division 3. Judgment will be entered for 1918-1919-1920. For 1921 dismissed.

Dec. 19—Motion to vacate order of June 29, 1929 and for further order filed by General Counsel. December 19, 1929 Denied.

" 21—Petition for review by U. S. Circuit Court of Appeals (9) with assignments of error—filed by General Counsel. (See 6988)

" 26—Proof of service of petition for review filed. (Resp't) (J. Robt. Sherrod)

1930

Jan. 8—Proof of service of petition for review filed. (Respondent) (Dana Latham)

" 8—Proof of service of petition for review filed. (Respondent) (Geo. M. Naus) (N. L. McLaren)

" 8—Proof of service of petition for review filed. (Respondent) (San Joaquin Fruit & Investment Co.)

Feb. 19—Motion for extension to April 24, 1930 for settlement and transmission of record, filed by General Counsel.

" 19—Order enlarging time to April 24, 1930 for preparation of evidence and delivery of record papers, entered.

1930

Apr. 21—Motion for extension to May 24, 1930 to prepare evidence and transmit record, filed by General Counsel.

" 22—Order enlarging time to May 24, 1930 for preparation of evidence and delivery of record papers entered.

May 23—Motion for extension to July 1, 1930 to prepare evidence and transmit record, filed by General Counsel.

" 24—Order enlarging time to July 1, 1930 for preparation of evidence and delivery of record, entered.

June 28—Motion for extension to August 1, 1930 to prepare statement and transmit record, filed by General Counsel.

" 30—Order enlarging time to August 1, 1930 for preparation of evidence and delivery of record entered.

July 24—Motion for extension to Oct. 1, 1930 to prepare statement and transmit record, filed by General Counsel.

" 26—Order enlarging time to October 1, 1934 for preparation of evidence and delivery of record entered.

Oct. 1—Motion for extension to November 15, 1930 to prepare and transmit record, filed by General Counsel.

" 3—Notice of objections to motion for extension, filed by taxpayer.

" 1—Order enlarging time to October 7, 1930 for preparation of evidence and delivery of record entered. [2]

1930

Oct. 7—Motion for extension to November 1, 1930 to prepare and transmit record, filed by General Counsel.

" 7—Order enlarging time to October 14, 1930 for preparation of evidence and delivery of record entered.

" 11—Statement of evidence lodged.

" 13—Praecipe with proof of service thereon filed.

" 13—Notice of lodgment of statement and of hearing on October 22, 1930 to approve said statement, filed.

" 13—Motion for extension to November 15, 1930 to prepare and transmit record, filed by General Counsel.

" 14—Order enlarging time to November 15, 1930 for preparation of evidence and delivery of record, entered.

" 21—Motion for extension to November 5, 1930 to submit alternative proposed statement of evidence, filed by taxpayer. October 24, 1930 granted.

Nov. 5—Hearing had before Mr. Murdock on approval statement of evidence. That page 20 of the statement of evidence be rewritten to include what petitioner stated during course of trial.

" 21—Statement of evidence approved and ordered filed.

1930

Nov. 15—Order enlarging time to November 24, 1930 for preparation of evidence *sur* petition for review and to January 15, 1931 for transmission of the record entered.

Dec. 19—Transcript of record *sur* petition for review sent Clerk U. S. Circuit Court of Appeals (San Francisco, Calif.)

1931

July 31—Mandate affirming decision as to years 1918 and 1919 and reversing as to years 1920 and 1921 filed.

Aug. 4—Order placing proceeding upon Day Calendar of October 5, 1931 for hearing on the merits entered.

" 20—Motion to place on the next Los Angeles Circuit Calendar filed by taxpayer. August 22, 1931 granted.

Oct. 13—Motion that Board fix time for filing briefs upon questions other than special assessment and after decision is rendered to set for hearing in Washington filed by General Counsel.

" 20—Hearing set November 4, 1931 on motion.

" 23—Statement in opposition to respondent's motion filed by taxpayer.

Nov. 4—Hearing had before Mr. Marquette—Division 1—on motion to submit case on evidence already taken—C. A. V.

" 10—Transcript of hearing November 4, 1931 filed.

1932

Jan. 9—Order denying respondent's motion to decide the issues involved, other than the issue of special assessment, and that proceeding be continued on the circuit calendar for the presentation of further evidence entered.

April 13—Hearing set for Los Angeles, California beginning May 23, 1932.

May 9—Application for subpoena duces tecum to N. L. McLaren filed by General Counsel.

" 9—Subpoena to N. L. McLaren issued. [3]

May 17—Application for subpoena to Andrew H. Cock et al filed by General Counsel.

" 16—Subpoenas (2) to Andrew H. Cock et al issued.

" 24—Hearing had before Mr. Seawell on merits. Submitted. Dockets 6989—20801—27038—35835—40407—42726—49317—52253 consolidated for hearing called from calendar of May 23, 1932. Briefs due in sixty days. Reply in 30 days.

July 1—Motion for extension of 30 days to file brief filed by taxpayer. July 6, 1932 granted.

" 21—Motion for extension of thirty days after transcript is filed to file brief, filed by General Counsel.

" 22—Motion for extension of thirty days after transcript granted both parties to September 9, 1932.

1932

Sept. 6—Motion for extension of thirty days after transcript is filed to file brief filed by General Counsel.

" 8—Brief filed by taxpayer.

" 7—Order granting both parties thirty days, after date when transcript is filed, for briefs entered.

Nov. 25—Brief filed by General Counsel.

Dec. 5—Transcript of hearing of May 23 and 24, 1932 filed. Volume I and II.

" 20—Motion for extension to February 1, 1933 to file reply brief, filed by taxpayer. December 22, 1932 granted, to both parties.

1933

Jan. 30—Reply brief filed by taxpayer.

Feb. 23—Motion for leave to file reply brief, brief tendered, filed by General Counsel.

June 15—Opinion rendered. Herbert F. Seawell, Division 4. Decision will be entered under Rule 50.

July 12—Notice of settlement filed by General Counsel.

" 15—Hearing set August 2, 1933 on settlement.

" 27—Consent to settlement filed by taxpayer.

" 31—Decision entered—Annabel Matthews, Division 13.

Oct. 25—Petition for review by U. S. Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

" 25—Proof of service filed by taxpayer.

1933

Dec. 8—Statement of evidence lodged.

" 8—Notice of lodgment of statement and of hearing December 20, 1933 to approve statement filed.

" 18—Praecipe with proof of service thereon filed.

" 18—Motion for extension to February 24, 1934 to complete the record, filed by taxpayer.

" 18—Order enlarging time to February 24, 1934 for preparation of evidence and transmission of record entered.

" 20—Hearing had before Mr. Seawell on approval of statement of evidence. That statement of evidence be rewritten by petitioner.

" 20—Exceptions to statement of evidence lodged with the Board, December 8, 1933 filed by General Counsel.

1934

Jan. 27—Order that transcript of record be incorporated in statement of evidence by reference thereto entered. [4]

Feb. 20—Motion for extension to May 24, 1934 to complete the record, filed by taxpayer.

" 20—Order enlarging time to May 24, 1934 for preparation of evidence and delivery of record entered.

Mar. 16—Statement of evidence lodged.

" 16—Notice of lodgment of statement of hearing March 21, 1934 to approve statement filed.

1934

Mar. 21—Hearing had before Mr. Seawell. Exceptions to amended statement of evidence. Statement of evidence approved with corrections. Exceptions to amended statement of evidence filed by respondent.

" 21—Statement of evidence approved and ordered filed.

" 29—Amended praecipe with proof of service thereon filed by taxpayer.

May 21—Second amended praecipe with proof of service thereon filed by taxpayer.

May 23—Order extending time for transmission and delivery of record to June 1, 1934 entered. [5]

Docket No. 20,801.

SAN JOAQUIN FRUIT & INVESTMENT CO.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPEARANCES.

For Petitioner:
J. R. SHERROD, Esq.
N. L. McLAREN, C. P. A.
GEO. M. NAUS, Esq.
DANA LATHAM, Esq.

For Respondent:
JOHN D. FOLEY, Esq.
LLOYD CREASON, Esq.

DOCKET ENTRIES.

1926.

Oct. 25—Petition received and filed. Taxpayer notified.

Oct. 27—Copy of petition served on General Counsel.

Dec. 27—Answer filed by General Counsel.

1927.

Jan. 22—Copy of answer served on taxpayer—Assigned Circuit Calendar.

Feb. 25—Hearing date set 5/3/27, Los Angeles, Calif.

1927

Mar. 30—Application for subpoena filed by taxpayer. [6]

May 2—Hearing had before Mr. Marquette, submitted. Continued to reserve calendar.

May 2—Order continuing proceeding to Reserve Calendar, signed and filed. Both sides notified.

May 25—Transcript of hearing of 5/3/27 filed.

1928.

Apr. 11—Order placing proceeding on General Calendar entered.

June 27—Hearing date set 9/19/28.

July 31—Motion to consolidate with dockets 6988 and 6989 and place on the San Francisco Circuit Calendar filed by taxpayer. See 6988.

Aug. 2—Hearing date set on motion Aug. 15, 1928.

Aug. 3—Copy of motion served on General Counsel.

Aug. 15—Hearing had before Mr. Sternhagen on motion to place on Circuit Calendar; withdrawn. Continued to Oct. 16, 1928.

Aug. 15—Order consolidating this docket with 6988 and 6989 and set for hearing 10/16/28 entered.

Sept. 27—Application for subpoena duces tecum filed taxpayer. See 6988.

Oct. 1—Subpoena duces tecum issued. Subpoena served 10/4/28.

Oct. 1—Order on application for subpoena duces tecum entered. [7]

1928

Oct. 10—Motion for leave to file amended petition, amendment tendered, filed by taxpayer.

Oct. 16—Hearing had before Mr. Murdock on merits. Submitted. Briefs due 12/15/28.

Nov. 13—Transcript of hearing of 10/16/28 filed.

Dec. 15—Brief filed by taxpayer. See 6988.

Dec. 17—Motion for extension to Jan. 14, 1929, to file brief filed by General Counsel. See 6988. Granted 12/18/28.

1929.

Jan. 14—Brief filed by General Counsel. See 6988.

June 29—Decision entered—B. H. Littleton, Division 4.

June 29—Opinion rendered—John E. Murdock, Division 3. Judgment will be entered for 1918, 1919, 1920 and for 1921, dismissed.

Dec. 19—Motion for order vacating order of June 29, 1929, and for further order filed by General Counsel. Denied.

Dec. 21—Petition for review by U. S. Circuit Court of Appeals (9) with assignments of error filed by General Counsel. See 6988.

Dec. 26—Proof of service filed. (J. R. Sherrod.)

1930.

Jan. 8—Proof of service filed. (Dana Latham.) See 6988.

Jan. 8—Proof of service filed. (Geo. M. Naus.)

[8]

Jan. 8—Proof of service filed. (San Joaquin Fruit & Investment Co.)

1930

Feb. 19—Motion for extension to Apr. 24, 1930, for settlement and transmission of record filed by General Counsel. See 6988.

Feb. 19—Order enlarging time to Apr. 24, 1930, for preparation of evidence and delivery of record papers entered.

Apr. 21—Motion for extension to May 24, 1930, to prepare evidence and transmit record filed by General Counsel.

Apr. 22—Order enlarging time to May 24, 1930, for preparation of evidence and delivery of record papers entered.

May 23—Motion for extension to July 1, 1930, to prepare statement of evidence and transmit record filed by General Counsel.

May 24—Order enlarging time to July 1, 1930, for preparation of evidence and delivery of record entered.

June 28—Motion for extension to Aug. 1, 1930, to prepare and transmit record filed by General Counsel.

June 30—Order enlarging time to Aug. 1, 1930, for preparation of evidence and delivery of record entered.

July 24—Motion for extension to Oct. 1, 1930, to prepare evidence and transmit record filed by General Counsel.

July 26—Order enlarging time to Oct. 1, 1930, for preparation of evidence and delivery of record entered. [9]

1930.

Oct. 1—Motion for extension to 11/15/30, to prepare and transmit record, filed by General Counsel.

Oct. 3—Notice of objections to respondent's motion for extension of time, filed by taxpayer.

Oct. 1—Order enlarging time to Oct. 7, 1930, for preparation of evidence and delivery of record entered.

Oct. 7—Motion for extension to 11/1/30, to prepare and transmit record filed by General Counsel.

Oct. 7—Order enlarging time to Oct. 14, 1930, for preparation of evidence and delivery of record entered.

Oct. 11—Statement of evidence lodged.

Oct. 13—Praecipe filed by General Counsel. Proof of service thereon.

Oct. 13—Notice of lodgment of statement and of hearing on 10/22/30 to approve said statement filed.

Oct. 13—Motion for extension to 11/15/30 to prepare and transmit record filed by General Counsel.

Oct. 14—Order enlarging time to Nov. 15, 1930, for preparation of evidence and delivery of record entered.

Oct. 21—Motion for extension to 11/5/30 to file alternative proposed statement of evidence filed by taxpayer. 10/24/30 granted. [10]

1930.

Nov. 5—Hearing had before Mr. Murdock on approval of statement of evidence. Page 20 of the statement of evidence be rewritten to include what counsel for respondent stated during course of trial.

Nov. 21—Statement of evidence approved and ordered filed.

Nov. 15—Order enlarging time to Nov. 24, 1930, for preparation of evidence *sur* petition for review and to Jan. 15, 1931, for transmission of the record entered. [11]

Dec. 19—Transcript of record *sur* petition for review sent clerk U. S. Circuit Court of Appeals. (San Francisco, California.)

1931.

July 31—Mandate from U. S. Circuit Court of Appeals, Ninth Circuit, affirming Board's decision as to years 1918 and 1919, and reversing as to years 1920 and 1921—filed.

Aug. 4—Order placing proceeding on Day Calendar of October 5, 1931, for hearing on the merits entered.

" 20—Motion to place on the next Los Angeles, California, Circuit Calendar filed by taxpayer. August 22, 1931, granted.

Oct. 13—Motion that Board fix a time for filing briefs on questions other than special assessment and after decision the case to be set for hearing in Washington filed by General Counsel.

1931

Oct. 20—Hearing set November 4, 1931 on motion.

" 23—Statement in opposition to respondent's motion filed by taxpayer.

Nov. 4—Hearing had before Mr. Marquette, Division 1, on motion to submit case on evidence already taken. C. A. V.

" 10—Transcript of hearing November 4, 1931 filed.

1932.

Jan. 9—Order denying respondent's motion to decide the issues involved, other than the issues of special assessment, and that proceeding be continued on the circuit calendar for the presentation of further evidence, entered.

Apr. 13—Hearing set for Los Angeles, California, beginning May 23, 1932.

" 20—Application for subpoena duces tecum to C. E. Utt, et al, filed by General Counsel.

" 20—Subpoenas (2) duces tecum to C. E. Utt, et al, issued.

May 9—Application of subpoena duces tecum to N. L. McLaren filed by General Counsel.

" 9—Subpoena to N. L. McLaren issued.

" 17—Application for subpoena to Andrew H. Cock, et al, filed by General Counsel.

" 16—Subpoenas (2) to Andrew H. Cock, et al, issued.

1932

May 24—Hearing had before Mr. Seawell on merits. Submitted. Called on calendar of May 23, 1932. Consolidated for hearing with 6989, 27038, 35835, 40407, 42726, 49317, 52253. Briefs due in sixty days, thirty days for reply. (Board not to serve.)

July 1—Motion for extension of thirty days to file brief, filed by taxpayer. July 6, 1932 granted.

" 23—Motion for extension of thirty days after receipt of transcript to file brief, filed by General Counsel.

" 23—Motion for extension of thirty days after receipt of transcript to file brief granted to both parties to September 9, 1932.

Sept. 6—Motion for extension of thirty days after receipt of transcript to file brief filed by General Counsel.

" 8—Brief filed by taxpayer.

" 7—Order granting both parties thirty days after date when transcript is filed for briefs entered.

Nov. 25—Brief filed by General Counsel. [12]

Dec. 5—Transcript of hearing on May 23 and 24, 1932 filed. Volume I and II.

" 20—Motion for extension to February 1, 1933 to file reply brief, filed by taxpayer. December 22, 1932 granted, to both parties.

1933 -

Jan. 30—Reply brief filed by taxpayer.

Feb. 23—Motion for leave to file reply brief, brief tendered, filed by General Counsel.

June 15—Opinion rendered. Herbert F. Seawell, Division 4. Decision will be entered under Rule 50.

July 12—Notice of settlement filed by General Counsel.

" 15—Hearing set August 2, 1933 on settlement.

" 27—Consent to settlement filed by taxpayer.

" 31—Decision entered. Annabel Matthews, Division 13.

Oct. 25—Petition for review by U. S. Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

" 25—Proof of service filed by taxpayer.

Dec. 8—Statement of evidence lodged.

" 8—Notice of lodgment of statement and of hearing December 20, 1933 to approve statement filed.

" 18—Praecipe with proof of service thereon filed.

" 18—Motion for extension to February 24, 1934 to complete the record filed by taxpayer.

" 18—Order enlarging time to February 24, 1934 for preparation of evidence and transmission of record entered.

" 20—Hearing had before Mr. Seawell on approval of statement of evidence. That statement of evidence be rewritten by petitioner.

1933

Dec. 20—Exceptions to statement of evidence lodged with the Board on December 8, 1933 filed by General Counsel.

1934

Jan. 27—Order that transcript of record may be incorporated in statement of evidence simply by reference thereto entered.

Feb. 20—Motion for extension to May 24, 1934 to complete the record, filed by taxpayer.

" 20—Order enlarging time to May 24, 1934 for preparation of evidence and delivery of record, entered.

Mar. 16—Statement of evidence lodged.

" 16—Notice of lodgment of statement and of hearing March 21, 1934 to approve statement filed.

" 21—Hearing had before Mr. Seawell. Exceptions to amended statement of evidence. Statement of evidence approved with corrections. Exceptions to amended statement of evidence filed by respondent.

" 21—Statement of evidence approved and ordered filed.

" 29—Amended praecipe with proof of service thereon filed.

May 21—Second amended praecipe with proof of service thereon filed by taxpayer.

May 23—Order extending time for transmission and delivery of record to June 1, 1934 entered. [13]

Docket No. 27038

SAN JOAQUIN FRUIT & INVESTMENT CO., Successor to SAN JOAQUIN FRUIT CO., thru change of name only,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPEARANCES

For Taxpayer:

CLAUDE I. PARKER, Esq.,
(Withdrawn)
JOHN B. MILLIKEN, Esq.,
J. R. SHERROD, Esq.,
GEO. M. NAUS, Esq.

For Commissioner:

JOHN D. FOLEY, Esq.,
J. R. JOHNSTON, Esq.

DOCKET ENTRIES

1927

Apr. 21—Petition received and filed. Taxpaper notified.

" 23—Copy of petition served on General Counsel.

May 25—Answer filed by General Counsel.

" 26—Copy of answer served on taxpayer—General Calendar.

1927

Apr. 21—Request that proceeding be placed on the Los Angeles, California Circuit Calendar. Granted May 28, 1927.

1928

Nov. 2—Motion to consolidate with Docket No. 40407 for hearing, filed by taxpayer.

" 3—Motion granted.

1929

May 3—Motion for leave to file amended petition, amendment tendered, filed by taxpayer.

" 6—Motion granted.

" 9—Copy of motion and amendment served on General Counsel.

July 5—Objections to the Board's action in filing an amended petition and answer to amended petition filed by General Counsel. Copy served July 10, 1929.

1930

Jan. 16—Notice of appearance of John B. Milliken as attorney for taxpayer filed.

Aug. 20—Motion to limit hearing to issues raised in amended pleadings filed by taxpayer.

" 21—Notice of the appearance of J. Robt. Sherrod, counsel for taxpayer filed.

" 22—Hearing set August 27, 1930 on petitioner's motion.

" 23—Copy of motion to limit hearing served on General Counsel.

" 25—Motion for hearing at Washington, D. C., filed by General Counsel.

" 29—Transcript of hearing August 27, 1930 filed.

1930

Aug. 27—Hearing had before Mr. Black on petitioner's motion to limit hearing and put on circuit calendar. C. A. V. Mr. Black.

Sept. 4—Order denying motion to place on Washington Calendar entered.

" 4—Order granting motion to limit hearing and placing on Los Angeles Calendar entered.

" 6—Hearing set October 15, 1930, Los Angeles, California. [14]

Sept. 8—Motion for continuance to next Los Angeles Calendar filed by taxpayer. September 10, 1930 granted.

" 10—Hearing had before Mr. Seawell and Miss Matthews on motion to continue from Los Angeles Calendar October 15, 1930 to later date. Granted to circuit calendar.

1931

Apr. 13—Hearing set June 1, 1931 at Los Angeles, California.

May 8—Motion to place on Reserve Calendar filed by taxpayer. May 8, 1931 Granted to Reserve A.

Aug. 20—Motion for circuit hearing at Los Angeles filed by taxpayer. August 22, 1931 granted.

Sept. 21—Notice of the appearance of Geo. M. Naus —counsel for taxpayer filed.

" 21—Notice of the withdrawal of Claude I. Parker—counsel for taxpayer filed.

1932

Apr. 13—Hearing set for Los Angeles, California beginning May 23, 1932.

May 9—Application for subpoena of N. L. McLaren—filed by General Counsel.

" 9—Subpoena issued—N. L. McLaren.

" 16—Subpoena issued—A. H. Cook.

" 16—Subpoena issued—W. A. Cook.

" 17—Application for subpoenas of W. A. Cook & A. W. Cook—filed by General Counsel.

" 24—Hearing had before Mr. Seawell—Division 4—on merits. Amended petition filed in 40407-42726-49317 & 52253 and amended answer in 35835, all consolidated for hearing. Briefs due—sixty days from date—thirty days for reply. (Board not exchange or serve.)

July 1—Motion for thirty day extension to file brief—filed by taxpayer. July 6, 1932 Granted.

" 23—Motion for thirty day extension to file brief after transcript filed by General Counsel.

" 23—Motion of July 23, 1932—granted both parties to September 9, 1932.

Sept. 6—Motion for thirty days extension after receipt of transcript to file brief—filed by General Counsel.

" 8—Brief filed by taxpayer.

" 7—Order extending time for period of thirty days after date when transcript is filed entered.

1932

Nov. 25—Brief filed by General Counsel.

Dec. 5—Transcript of hearing May 23-24, 1932 filed. Volume I.

" 5—Transcript of hearing May 23-24, 1932 filed. Volume II.

" 20—Motion for extension to February 1, 1933 to file reply brief filed by taxpayer. December 22, 1932 Granted, both parties to February 1, 1933.

1933

Jan. 30—Reply brief filed by taxpayer.

Feb. 23—Motion for leave to file reply brief filed by General Counsel. Reply brief lodged.

June 15—Opinion rendered—Mr. Seawell—Division 4—Decision will be entered under Rule 50 except in Docket 35835. [15]

July 12—Notice of settlement filed by General Counsel.

" 15—Hearing set for August 2, 1933 on settlement.

" 27—Consent to settlement filed by taxpayer.

" 31—Decision entered—Annabel Matthews. Division 13.

Oct. 25—Petition for review by U. S. Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

" 25—Proof of service filed by taxpayer.

Dec. 8—Statement of evidence lodged.

" 8—Notice of lodgment of statement of evidence, hearing set December 20, 1933—proof of service of notice thereon—filed.

1933

Dec. 18—Praecipe with proof of service thereon filed.

" 18—Motion for extension to February 24, 1934 to complete the record, filed by taxpayer.

" 20—Hearing had before Mr. Seawell—Division 4—on approval of statement of evidence. The statement of evidence be rewritten by petitioner.

" 18—Order enlarging time to February 24, 1934 for preparation of evidence and delivery of record entered.

" 20—Exceptions to statement of evidence lodged with Board—December 8, 1933, filed by General Counsel.

1934

Jan. 27—Order from U. S. Circuit Court of Appeals that transcript of record be incorporated in statement of evidence—simply by reference thereto—filed.

Feb. 20—Motion for extension to May 24, 1934 to complete the record filed by taxpayer.

" 20—Order enlarging time to May 24, 1934 to prepare evidence and transmit record entered.

Mar. 16—Statement of evidence lodged.

" 16—Notice of lodgment of statement and of hearing March 21, 1934 to approve statement filed.

1934

Mar. 21—Hearing had before Mr. Seawell—(4)—Exceptions to amended statement of evidence, statement of evidence approved with corrections—Exceptions to amend statement of evidence filed by Commissioner.

" 21—Statement of evidence approved and ordered filed.

" 29—Amended praecipe filed—proof of service thereon.

May 21—Second Amended praecipe with proof of service thereon filed by taxpayer.

May 23—Order enlarging time for transmission and delivery of record to June 1, 1934 entered.

[16]

Docket No. 40407

SAN JOAQUIN FRUIT & INVESTMENT CO.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPEARANCES

For Taxpayer:
JOHN B. MILLIKEN, Esq.,
GEO. M. NAUS, Esq.,
JOSEPH D. PEELER, Esq.,

For Commissioner:
J. R. JOHNSTON, Esq.

DOCKET ENTRIES

1928

Aug. 22—Petition received and filed. Taxpayer notified. (Fee paid.)

" 24—Copy of petition served on General Counsel.

Oct. 23—Answer filed by General Counsel.

" 29—Copy of answer served on taxpayer. General Calendar. (Filed.)

Nov. 2—Motion to consolidate with Docket No. 27038 for hearing at Los Angeles, California. filed by taxpayer. See 27038. Granted November 3, 1928.

1930

Jan. 16—Notice of appearance of John B. Milliken as counsel for the taxpayer, filed.

1931

Apr. 13—Hearing set June 1, 1931, Los Angeles, California.

May 8—Motion to place on the Reserve Calendar filed by taxpayer. May 8, 1931 granted to Reserve A.

Aug. 20—Motion to place on the Los Angeles Circuit Calendar filed by taxpayer. August 22, 1931, granted.

Sept. 21—Notice of appearance of Geo. M. Naus and withdrawal of Claude I. Parker as counsel filed.

1932

Apr. 13—Hearing set for Los Angeles, California beginning May 23, 1932.

1932.

May 24—Hearing had before Mr. Seawell on merits. Submitted. Called from calendar of May 23, 1932. Amended petition received and served. Dockets 6989, 20801, 27038, 35835, 40407, 42726, 49317, 52253 consolidated for hearing. Briefs due in sixty days, thirty days for reply. (Board not to serve.)

July 1—Motion for extension of thirty days to file brief, filed by taxpayer. July 6, 1932, granted.

" 23—Motion for extension of thirty days after receipt of transcript to file brief, filed by General Counsel.

" 23—Motion for extension of thirty days after receipt of transcript to file brief granted to both parties, to September 9, 1932.

Sept. 6—Motion for extension of thirty days after receipt of transcript to file brief filed by General Counsel.

" 8—Brief filed by taxpayer.

" 7—Order granting parties thirty days after date of transcript to file briefs entered.

Nov. 25—Brief filed by General Counsel. [17]

Dec. 5—Transcripts of hearing of May 23 and 24, 1932 filed. Volumes I and II.

" 20—Motion for extension to February 1, 1933 to file reply brief filed by taxpayer. December 22, 1932, Granted to both parties.

1933

Jan. 30—Reply brief filed by taxpayer.

Feb. 23—Motion for leave to file reply brief, brief tendered, filed by General Counsel.

June 15—Opinion rendered. Herbert F. Seawell, Division 4. Decision will be entered under Rule 50.

July 12—Notice of settlement filed by General Counsel.

" 15—Hearing set August 2, 1933 on settlement.

" 27—Consent to settlement filed by taxpayer.

" 31—Decision entered. Annabel Matthews, Division 13.

Oct. 25—Petition for review by U. S. Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

" 25—Proof of service filed by taxpayer.

Dec. 8—Statement of evidence lodged.

" 8—Notice of lodgment of statement and of hearing December 20, 1933 to approve statement filed.

" 18—Praecipe with proof of service thereon filed.

" 18—Motion for extension to February 24, 1934 to complete the record, filed by taxpayer.

" 18—Order enlarging time to February 24, 1934 for preparation of evidence and transmission of record entered.

" 20—Hearing had before Mr. Seawell on approval of statement of evidence. That statement of evidence be rewritten by petitioner.

1933

Dec. 20—Exceptions to statement of evidence lodged with the Board December 8, 1933 filed by General Counsel.

1934.

Jan. 27—Order that transcript of record may be incorporated in statement of evidence simply by reference thereto entered.

Feb. 20—Motion for extension to May 24, 1934 to complete the record filed by taxpayer.

" 20—Order enlarging time to May 24, 1934 for preparation of evidence and delivery of record entered.

Mar. 16—Statement of evidence lodged.

" 16—Notice of lodgment of statement and of hearing March 21, 1934 to approve statement filed.

" 21—Hearing had before Mr. Seawell on exceptions to amend statement of evidence. Statement of evidence approved with corrections. Exceptions to amended statement of evidence filed by respondent.

" 21—Statement of evidence approved and ordered filed.

" 29—Amended praecipe with proof of service thereon filed.

May 21—Second amended praecipe with proof of service thereon filed by taxpayer.

May 23—Order enlarging time for transmission and delivery of record to June 1, 1934 entered. [18]

Docket No. 42726

SAN JOAQUIN FRUIT & INVESTMENT CO.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPEARANCES

For Taxpayer:
CLAUDE I. PARKER, Esq.
(Withdrawn)
JOHN B. MILLIKEN, Esq.,
JOSEPH D. PEELER, Esq.,
GEO. M. NAUS, Esq.,

For Commissioner:
J. R. JOHNSTON, Esq.

DOCKET ENTRIES

1929

Feb. 14—Petition received and filed. Taxpayer notified. (Fee paid.)

" 15—Copy of petition served on General Counsel.

April 16—Answer filed by General Counsel.

" 19—Copy of answer served on taxpayer. Circuit Calendar.

1930.

Jan. 16—Notice of appearance of John B. Milliken as counsel for the taxpayer filed.

1931.

Apr. 13—Hearing set June 1, 1931, Los Angeles, California.

May 8—Motion to place on Reserve Calendar filed by taxpayer. May 8, 1931 granted to Reserve A.

Aug. 20—Motion to place on circuit calendar for hearing at Los Angeles, filed by taxpayer.

" 22—Motion to place on circuit calendar for hearing at Los Angeles granted.

Sept. 21—Notice of the appearance of Geo. M. Naus, counsel for taxpayer filed.

" 21—Notice of the withdrawal of Claude I. Parker, counsel for taxpayer filed.

1932

April 13—Hearing set for Los Angeles, California beginning May 23, 1932.

May 24—Hearing had before Mr. Seawell on merits. Submitted. Amended petition received and served. Dockets 6989, 20801, 27038, 35835, 40407, 42726, 49317, 52253 consolidated for hearing. Briefs due in sixty days, thirty days for reply. (Board not to serve.)

July 1—Motion for thirty days extension to file brief filed by taxpayer. July 6, 1932 granted.

" 23—Motion for thirty days extension to file brief filed by General Counsel.

" 23—Motion for thirty days extension after receipt of transcript to file brief granted to both parties to September 9, 1932.

1932

Sept. 6—Motion for thirty days after receipt of transcript to file brief filed by General Counsel.

Sept. 8—Brief filed by taxpayer.

" 7—Order granting parties thirty days after date of transcript for briefs entered.

Nov. 25—Brief filed by General Counsel. [19]

Dec. 5—Transcript of hearing of May 23 and 24, 1932 filed. Volume I and II.

" 20—Motion for extension to February 1, 1933 to file reply brief filed by taxpayer. December 22, 1932 granted to both parties.

1933

Jan. 30—Reply brief filed by taxpayer.

Feb. 23—Motion for leave to file reply brief by General Counsel. Reply brief lodged.

June 15—Opinion rendered. Herbert F. Seawell, Division 4. Decision will be entered under Rule 50.

July 12—Notice of settlement filed by General Counsel.

July 15—Hearing set August 2, 1933 on settlement.

" 27—Consent to settlement filed by taxpayer.

" 31—Decision entered. Annabel Matthews, Division 13.

Oct. 25—Petition for review by U. S. Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

" 25—Proof of service filed by taxpayer.

Dec. 8—Statement of evidence lodged.

" 8—Notice of the lodgment of statement of evidence, hearing set December 20, 1933, proof of service thereon.

1933

Dec. 18—Praecipe with proof of service thereon filed.

" 18—Motion for extension to February 24, 1934, to complete the record, filed by taxpayer.

" 18—Order enlarging time to February 24, 1934 for preparation of evidence and transmission of record entered.

" 20—Hearing had before Mr. Seawell on approval of statement of evidence. That statement of evidence be rewritten by petitioner.

" 20—Exceptions to statement of evidence lodged with the Board December 8, 1933 filed by General Counsel.

1934

Jan. 21—Order from U. S. Circuit Court of Appeals, Ninth Circuit, that transcript of record may be incorporated in statement of evidence simply by reference thereto—filed.

Feb. 20—Motion for extension to May 24, 1934 to complete the record, filed by taxpayer.

" 20—Order enlarging time to May 24, 1934 for preparation of evidence and delivery of record entered.

Mar. 16—Statement of evidence lodged.

" 16—Notice of lodgment of statement and of hearing March 21, 1934 to approve statement filed.

1934

Mar. 21—Hearing had before Mr. Seawell on exceptions to amended statement of evidence. Statement of evidence approved with corrections. Exceptions to amended statement of evidence filed by respondent.

" 21—Statement of evidence approved and ordered filed.

" 29—Amended praecipe filed—proof of service thereon.

May 21—Second amended praecipe with proof of service thereon filed by taxpayer.

May 23—Order enlarging time for transmission and delivery of record to June 1, 1934 entered.

[20]

Docket No. 49317

SAN JOAQUIN FRUIT AND INVESTMENT CO.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

APPEARANCES

For Taxpayer:

JOHN B. MILLIKEN, Esq.,
GEO. M. NAUS, Esq.,
JOSEPH D. PEELER, Esq.,

For Commissioner:

J. R. JOHNSTON, Esq.

DOCKET ENTRIES

1930

June 20—Petition received and filed. Taxpayer notified. (Fee paid.)

" 21—Copy of petition served on General Counsel.

Aug. 20—Answer filed by General Counsel.

" 29—Copy of answer served on taxpayer. Assigned to Circuit Calendar.

1931

April 13—Hearing set June 1, 1931 at Los Angeles.

May 8—Motion to place on Reserve Calendar filed by taxpayer. Granted to Reserve A.

Aug. 20—Motion to place on Circuit Calendar for hearing at Los Angeles, California, filed by taxpayer.

" 22—Motion to place on Circuit Calendar for hearing at Los Angeles, California granted.

Sept. 21—Notice of the appearance of Geo. M. Naus, counsel for taxpayer filed.

" 21—Notice of the withdrawal of Claude I. Parker, counsel for taxpayer filed.

1932

April 13—Hearing set for Los Angeles, California, beginning May 23, 1932.

May 24—Calendar call May 23, 1932. Hearing had before H. F. Seawell, Division 4 on merits. Submitted. Amended petition received and served. Consolidated for hearing with 40407-42726-52253. Briefs due sixty days from date. Thirty days for reply. Board not to serve.

1932

July 1—Motion for thirty day extension to file brief—filed by taxpayer. July 6, 1932 granted.

" 23—Motion for thirty day extension to file brief—filed by taxpayer. July 23, 1932 granted to both parties to September 9, 1932.

Sept. 6—Motion for thirty day extension to file brief —filed by General Counsel.

" 8—Brief filed by taxpayer

" 7—Order that parties be granted extension of thirty days after date when transcript is filed to file briefs, entered.

Nov. 25—Brief filed by General Counsel.

Dec. 5—Transcript of hearing May 23 and 24, 1932 filed.

" 20—Motion for extension to February 1, 1933 to file reply brief filed by taxpayer. December 22, 1932 granted to both parties to February 1, 1933. [21]

1933

Jan. 30—Reply brief filed by taxpayer.

Feb. 23—Motion for leave to file reply brief, filed by General Counsel. Reply brief lodged.

June 15—Opinion rendered H. F. Seawell, Division 4. Decision will be entered under Rule 50.

July 12—Notice of settlement filed by General Counsel.

" 15—Hearing set August 2, 1933 under Rule 50.

" 27—Consent to settlement filed by taxpayer.

" 31—Decision entered Annabel Matthews, Division 13.

1933

Oct. 25—Petition for review by U. S. Circuit Court of Appeals, Ninth Circuit with assignments of error filed by taxpayer.

" 25—Proof of service filed by taxpayer.

Dec. 8—Statement of evidence lodged.

" 8—Notice of lodgment of statement of evidence—hearing set December 20, 1933—proof of service of notice thereon filed.

" 18—Praecipe with proof of service thereon filed.

" 18—Motion for extension to February 24, 1934 to complete the record filed by taxpayer.

" 18—Order enlarging time to February 24, 1934 to prepare evidence and deliver record entered.

" 20—Hearing had before Mr. H. F. Seawell, Division 4, on approval of statement of evidence. Order that petitioner rewrite statement of evidence.

" 20—Exception to statement of evidence lodged with the Board December 8, 1933 filed by General Counsel.

1934

Jan. 27—Order that transcript of record may be incorporated in statement of evidence simply by reference thereto filed.

Feb. 20—Motion for extension to May 24, 1934 to complete the record, filed by taxpayer.

" 20—Order enlarging time to May 24, 1934 for preparation of evidence and delivery of record entered.

1934

Mar. 16—Statement of evidence lodged.

" 16—Notice of lodgment of statement and of hearing Mar. 21, 1934 to approve statement filed.

" 21—Statement of evidence approved and ordered filed.

" 21—Hearing had before Mr. H. F. Seawell, Division 4, on approval of statement of evidence. Statement approved with corrections. Exceptions to amended statement of evidence filed by respondent.

Mar. 29—Amended praecipe filed—proof of service thereon.

May 21—Second amended praecipe with proof of service thereon filed by taxpayer.

May 23—Order enlarging time for transmission and delivery of record to June 1, 1934 entered. [22]

Docket No. 52253

SAN JOAQUIN FRUIT & INVESTMENT CO.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPEARANCES

For Taxpayer:
GEO. M. NAUS, Esq.,
JOSEPH D. PEELER, Esq.,
N. L. McLAREN, C. P. A.,
J. ROBT. SHERROD, Esq.

For Commissioner:
J. R. JOHNSTON, Esq.

DOCKET ENTRIES

1931

Jan. 26—Petition received and filed. Taxpayer notified. Fee paid.

" 26—Copy of petition served on General Counsel.

Feb. 13—Answer filed by General Counsel.

" 20—Copy of answer served on taxpayer. Circuit Calendar.

Sept. 21—Notice of the appearance of Geo. M. Naus, counsel for taxpayer filed.

" 21—Notice of the withdrawal of Claude I. Parker, counsel for taxpayer filed.

1931

Sept. 30—Motion to consolidate with 6989, 20801, 27038, 40407, 42726 and 49317 for hearing at Los Angeles—filed by taxpayer. October 1, 1931 Granted.

1932

April 13—Hearing set for Los Angeles, California beginning May 23, 1932.

May 24—Hearing had before Mr. Seawell on merits. Submitted. Amended petition received and served. Called on May 23, 1932. Dockets 6989, 20801, 27038, 35835, 40407, 42726, 49317, 52253 consolidated for hearing. Briefs due in sixty days, thirty days for reply. (Board not to serve)

July 1—Motion for thirty day extension to file briefs, filed by taxpayer. July 6, 1932 Granted.

" 23—Motion for thirty day extension after transcript to file briefs filed by General Counsel. Granted to both parties to September 9, 1932.

Sept. 6—Motion for thirty day extension after receipt of transcript to file brief, filed by General Counsel.

" 7—Order that both parties be granted extension to thirty days from date of transcript entered.

" 8—Brief filed by taxpayer.

Nov. 25—Brief filed by General Counsel.

Dec. 5—Transcript of hearing of May 23 and 24, 1932 filed. Volume I & II.

1932

Dec. 20—Motion for extension to February 1, 1933 to file reply brief filed by taxpayer.

" 20—Motion for extension of time within which to file reply brief granted both parties to February 1, 1933. [23]

1933

Jan. 30—Reply brief filed by taxpayer.

Feb. 23—Motion for leave to file reply brief filed by General Counsel. Reply Brief lodged.

June 15—Opinion rendered. Herbert F. Seawell, Division 4. Decision will be entered under Rule 50.

July 12—Notice of settlement filed by General Counsel.

July 15—Hearing set August 2, 1933 on settlement.

" 27—Consent to settlement filed by taxpayer.

" 31—Decision entered. Annabel Matthews, Division 13.

Oct. 25—Petition for review by U. S. Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by taxpayer.

" 25—Proof of service filed by taxpayer.

Dec. 8—Statement of evidence lodged.

" 8—Notice of lodgment of statement of evidence, hearing notice of December 20, 1933, proof of service of notice thereon filed.

" 18—Praecipe with proof of service thereon filed.

" 18—Motion for extension to February 24, 1934 to complete the record, filed by taxpayer.

1933

Dec. 20—Hearing had before Mr. Seawell on approval of statement of evidence. That statement of evidence be rewritten by petitioner.

" 18—Order enlarging time to February 24, 1934 for preparation of evidence and transmission of record entered.

" 20—Exceptions to statement of evidence lodged with the Board December 8, 1933 filed by General Counsel.

1934

Jan. 27—Order from U. S. Circuit Court of Appeals, Ninth Circuit, that transcript of record may be incorporated in statement of evidence simply by reference thereto, filed.

Feb. 20—Motion for extension to May 24, 1934 to complete the record, filed by taxpayer.

" 20—Order enlarging time to May 24, 1934 for preparation of evidence and delivery of record entered.

Mar. 16—Statement of evidence lodged.

" 16—Notice of lodgment of statement and of hearing March 21, 1934 to approve statement filed.

" 21—Hearing had before Mr. Seawell. Exceptions to amended statement of evidence. Statement of evidence approved with corrections. Exceptions to amend statement of evidence filed by respondent.

1934

Mar. 21—Statement of evidence approved and ordered filed.

" 29—Amended praecipe filed. Proof of service thereon.

May 21—Second amended praecipe with proof of service thereon filed by taxpayer.

May 23—Order enlarging time for transmission and delivery of record to June 1, 1934 entered. [24]

United States Board of Tax Appeals.

DOCKET No. 6989.

Appeal of SAN JOAQUIN FRUIT AND INVESTMENT CO. (Formerly SAN JOAQUIN FRUIT CO.), Tustin, California.

PETITION.

The above-named taxpayer hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter (IT:E:SM-CLB-C584-60D) dated July 27, 1925, and as the basis of its appeal sets forth the following:

1. The taxpayer is a California corporation with principal office in the city of Tustin, California.

2. The deficiency letter (a copy of which is attached, together with copy of Bureau letter dated June 16, 1925, referred to therein), was mailed to the taxpayer on July 27, 1925.

3. The taxes in controversy are income and profits taxes for the calendar year 1920 and are more than $10,000.00, to wit: $22,872.09 for the calendar year 1920, together with such additional sums as the Board may find to be legally refundable. [25]

4. The determination of tax contained in the said deficiency letter is based upon the following errors:

(a) That the Commissioner has refused to permit the taxpayer to include in its invested capital for the year 1920 the sum of $1,659,372.85, which represents a disallowance of surplus arising from a closed transaction which occurred on November 30, 1916, on which date the taxpayer exercised an option to acquire improved real estate, which option had been acquired on October 13, 1906, and had steadily and continuously increased in value through the ten-year period, and on the date of its exercise had a market value of $1,659,372.85.

(b) That the Commissioner has refused to permit the taxpayer to take a depreciation deduction for the year 1920, based on the value of fruit-trees at November 30, 1916, on which date title to the trees was acquired by the taxpayer, by exercise of said valuable option.

(c) That the Commissioner has refused to permit the taxpayer to take a depreciation deduction for the year 1920, based on a March 1, 1913, value of fruit-trees included in a leasehold and option owned by the taxpayer on March 1, 1913, which

leasehold and option was converted into fee simple ownership on November 30, 1916.

(d) That although the Commissioner has determined the taxpayer's income and profits tax liability for the year 1920, under the provisions of Sections 327 and 328 of the Revenue Act of 1918, the corporations selected by the Commissioner for this [26] purpose under the provisions of Section 328 did not constitute representative corporations engaged in the same line of business.

5. The facts upon which the taxpayer relies as the basis of its appeal are as follows:

(A) The taxpayer is engaged in the cultivation and sale of citrus fruits and nuts. During the year 1920 it owned in fee simple 1,000 acres of real estate of which 600 acres were planted to walnut trees and 400 acres to orange trees. The corporation was organized October 5, 1906, with a paid-in capital of $81,000.00. The entire capital stock was issued in equal parts to C. E. Utt, Sherman Stevens and James Irvine. The stock issued to James Irvine was shortly afterwards transferred to the Irvine Co. The Irvine Company (referred to hereinafter as the lessor) leased to the taxpayer for a term of ten years, beginning December 1, 1906, and ending November 30, 1916, 1,000 acres of land situated in Orange County, California, upon the following terms:

1. The taxpayer should, at its own expense, set out and plant within four years from the date thereof, all of said land in fruit-trees of various

varieties and should properly care for irrigating and cultivating the same and replace all trees that died during the ten-year term of the lease.

2. The taxpayer should also, at its own expense, and during the said term, cultivate crops of grain, beans, peanuts or other products on such portions of land as could be cultivated without material in-
[27] jury to the trees, and prepare such crops for the market at its own expense.

3. A quarter share of said crops including nuts and fruits should be paid to the lessor by the taxpayer as rental.

4. The taxpayer should agree to use every reasonable means to prevent the growth and spread of obnoxious weeds, and under certain conditions if such weeds were not checked, the crop rental was increased to one-half the average total amount produced per acre.

5. The taxpayer should not assign said lease or sublet any portion of the leased premises without the written consent of the lessor.

6. The taxpayer should, at its own expense, sink wells upon adjacent property owned by the lessor and develop sufficient water for the irrigation of all crops and trees grown upon said land, and construct at its own cost pipe-lines to conduct the water developed thereby to the said leased land, an option to purchase the lands whereon water had been developed by the taxpayer being granted by the lessor.

7. Upon satisfaction of all the conditions of the lease the taxpayer should have the option to pur-

chase any part or all of the leased lands on the last day of the lease at $200.00 per acre, payable ¼ cash on the exercise of the option and the balance in two equal payments within five years after date of purchase, the deferred payments to bear interest at 6% per annum. [28]

8. In the event that the taxpayer should not exercise its option to purchase said leased lands, then upon the expiration of the term of the lease, the lessor should have the option of purchasing from the taxpayer its entire water system and the water developed, upon the payment of the actual cost thereof, less depreciation.

9. The lease also provided that at any time after the entire 1,000 acres were set out to trees, and before the expiration of the lease, the taxpayer might purchase not to exceed ½ of the said leased lands upon the payment to the lessor of $200.00 per acre cash; but if such option were exercised then the option to purchase the balance of the land at the expiration of the lease was terminated.

10. After the expiration of the term of the lease, said option should cease and terminate as to the portion of said lands not purchased thereunder.

11. During the term of the lease all taxes upon the real estate were payable by the lessor and all taxes upon the improvements were payable by the taxpayer.

In accordance with the terms of the above contract the taxpayer corporation took possession of the leased property on or about November 1, 1906. The land at this time was dry and unirrigated. A

portion of it had been previously grown to crops of grain and beans but the remainder was still covered with cactus. Within six months' time the taxpayer cleared the land, filled in gulches, leveled the property for irrigation and set out 740 acres to trees. Before the end of the first year the irrigat- [29] ing system was so far advanced that water was being delivered to the highest portion of the land. Before the end of the third year the remaining 260 acres of land were planted to orchard trees.

During the ten-year period covered by the lease the entire time of two of the stockholders, Messrs. Utt and Stevens, was devoted to the affairs of the corporation, for which they received no compensation except nominal salaries of $100.00 per month each in the nature of drawing accounts for living expenses.

Before the expiration of the lease the property had been highly improved, including the installation of a complete underground irrigation system, electric lights and electric power, modern houses and rooms, dining-room for employees, maintenance of a large automobile bus for the benefit of school children, postoffice for employees and the employment of a gardener to maintain the appearance of the property immediately adjacent to the ranch headquarters.

On November 30, 1916, the taxpayer's option to purchase the property was exercised and the first payment of $75,000.00 provided by the contract was made. The second and final payments of $50,000.00

and $75,000.00 were made on December 31, 1917, and October 28, 1918, respectively.

On November 30, 1916, the value of the real estate and trees thus acquired by the corporation was $1,854,000.00 as determined by independent appraisal.

In its original return for the year 1920 the tax-[30] payer claimed as a part of its invested capital a paid-in surplus of $1,554,530.07, which represents the difference between the sum of $200,000.00 paid in cash as a portion of the purchase price of the property on November 30, 1916, and the value placed by the corporation on the real estate and trees on that date. Under date of January 25, 1922, the taxpayer revised its claim on the basis of independent appraisals and sought to obtain paid-in surplus in the sum of $1,659,372.85. The report of an Internal Revenue Agent dated November 14, 1921, disallowed the claim for paid-in surplus and the action of the examining agent in this respect was upheld by the Income Tax Unit. The application of the taxpayer for a hearing before the Solicitor of Internal Revenue was denied by the Income Tax Unit and the final computations set forth in the Internal Revenue Bureau's letter of July 27, 1925, make no allowance for any portion of the paid-in surplus claimed by the taxpayer.

Upon the exercise of said option, and ever since, this taxpayer corporation has had, and is entitled to include in its invested capital, earned surplus and undivided profits amounting to not less than

$1,659,372.85 arising from the conversion of capital assets.

(B) In its original return for the year 1920 the taxpayer deducted depreciation of $59,710.96 covering depreciation of its physical properties including trees. This deduction was reduced to $58,135.69 by the Revenue Agent, but the Commissioner eliminated the major portion of the depreciation deduc- [31] tion applicable to the taxpayer's orchard trees and did not give effect to the value of these assets at date of acquisition in establishing the deduction for depreciation. Said value as determined by independent appraisal was $1,100.00 per acre and the life of the trees was approximately 25 years from November 30, 1916.

(C) The value of the orchard trees leased to the taxpayer on March 1, 1913, and to which title was acquired by the taxpayer on November 30, 1916, was $1,115.00 per acre. In the report of the Internal Revenue Agent dated November 14, 1921, referred to hereinabove, depreciation on orchard trees at the rate of 3% was allowed upon a value of $1,115.00 per acre, which the agent upon investigation found to be conservative based on a life of 33 1-3 years. In computing the depreciation deduction based on the 1913 value the agent erred in using the rate of 3% for the reason that of the estimated life of the trees approximately five years had elapsed prior to March 1, 1913. Consequently the annual rate of depreciation based on the 1913 value should be increased to 3½. However, the Income Tax Unit refused to consider the value at

March 1, 1913, in establishing tree depreciation for the reason that title to the property was not acquired by the taxpayer until November 30, 1916. As indicated hereinabove, the taxpayer owned a property right on March 1, 1913, which was exchanged for a greater property right on November 30, 1916; but the Commissioner has not given effect either to the value of property rights at March 1, [32] 1913, or November 30, 1916, in establishing the depreciation deduction.

(D) The taxpayer's application for assessment under the provisions of Section 327 and 328 of the Revenue Act of 1918 was favorably entertained by the Commissioner, who determined that abnormalities of invested capital were present for the year 1920, entitling the taxpayer to assessment under these sections. A careful and diligent inquiry discloses the fact that the representative companies whose circumstances were similar to the taxpayer during the years in question failed to pay the rate of excess profits tax stated by the Commissioner to constitute the fair comparative rate.

6. The taxpayer in support of its appeal relies upon the following propositions of law:

(A) 1. Where a corporation exercises a valuable long term option to acquire property under lease to said corporation (which option has greatly and steadily increased in market value throughout the term thereof), the consideration being cash, together with the performance of covenants contained in the lease and option contract, and where such covenants require intensive development of

such leased property, its complete operation and the assumption of business hazards during the life of the lease and option, the difference between the cash consideration and the value of the assets acquired represents a portion of the corporation's invested capital under the purview of Section 326 (a) (3) of the Revenue Act of 1918, particularly if and when that difference is equivalent to the market value of the option exercised. [33]

2. Where a corporation exchanges cash and assets other than cash, which other assets have a definite market value, for property having a different form and identity in a *bona fide* transaction with a third person, then the aggregate of the cash and the market value of assets other than cash is the capital invested by the corporation in the property received in exchange.

(B) 1. Where a corporation exercises a valuable long term option to acquire property under lease to said corporation (which option has greatly and steadily increased in market value throughout the term thereof), the consideration being cash, together with the performance of covenants contained in the lease contract, and where such covenants consist of the intensive development of such leased property, its complete operation and the assumption of business hazards during the life of the lease, depreciation upon property subject to exhaustion acquired as the result of such a transaction is properly based upon its fair value at the date of acquisition under the purview of Section 234 (a) (7) of the Revenue Act of 1918.

2. Where a corporation acquires property in exchange for other property and the property received in the exchange is such as will physically deteriorate, the corporation is entitled to an allowance for depreciation based on the value of property that it give in the exchange.

(C) A leasehold is susceptible of depreciation under the purview of Section 234 (a) (7) of the Revenue Act of 1918 and if such leasehold is ex- [34] changed for absolute ownership of the same property, the taxpayer is not thereby deprived of depreciation based on the March 1, 1913, value of the property.

(D) Where the Commissioner has determined that abnormalities of invested capital or net income exist under the purview of Section 327 (d) of the Revenue Act of 1918 the Commissioner must compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined and which are as nearly as may be similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, in order to comply with the provisions of Section 328 (a) of the Revenue Act of 1918.

WHEREFORE, the taxpayer respectfully prays that this Board may hear and determine its appeal.

Respectfully submitted,

N. L. McLAREN,

GEORGE M. NAUS,

Counsel for the Taxpayer.

State of California,
County of Orange.—ss.

C. E. Utt, being duly sworn says that he is the President of the San Joaquin Fruit and Investment Company, a successor to the San Joaquin Fruit Company, the taxpayer named in the foregoing petition and as such President is duly authorized to verify the foregoing petition; that he has read the said petition or had the same read to him and is familiar with the statements therein contained [35] and that the facts therein stated are true, except such facts as are stated to be upon information and belief and these facts he believes to be true.

C. E. UTT,
President.

Subscribed and sworn to before me this 2d day of September, 1925.

[Seal] W. S. LEINBERGER,
Notary Public.

My commission expires Aug. 16, 1928.

TREASURY DEPARTMENT,
Washington.

July 27, 1925.

IT:E:SM.
CLB.-C584-60D.

San Joaquin Fruit and Investment Company,
Tustin, California.

Sirs: An audit of your income and profits tax return for the year ended December 31, 1920 has re-

sulted in the determination of a deficiency in tax of $22,872.09 as shown in Bureau letter dated June 16, 1925..

(Here follows regular 60-day letter.)

Respectfully,

D. H. BLAIR,
Commissioner.

By (Signed) C. B. ALLEN,
Acting Deputy Commissioner.

Enclosures:
Statements
Agreement—Form A. [36]

IT:E:SM.
CLB.-C584-60D.

SAN JOAQUIN FRUIT AND INVESTMENT CO.,
Tustin, California

Year Involved.	Deficiency in Tax.
Calendar year 1920	$22,872.09

No additional information having been submitted relative to your application for the assessment of your profits tax for the calendar year 1920 under the provisions of Section 328 of the Revenue Act of 1918, the Bureau holds that the action of the Unit as set forth in Bureau letter dated June 16, 1925 is correct and should be sustained.

June 16, 1925.

TREASURY DEPARTMENT,
Washington.

IT:E:SM.
CLB.-C-584.

San Joaquin Fruit and Investment Co.
Tustin, California.

Sirs: An audit of your income and profits tax return for the year ended December 31, 1920 has resulted in the determination of a deficiency in tax of $22,872.09 as shown in the attached statement.

(Here follows regular 30-day letter.)

Respectfully,
J. G. BRIGHT,
Deputy Commissioner.
By (Signed) I. T. ENES,
Chief of Section. [37]

STATEMENT:

In re: SAN JOAQUIN FRUIT AND INVESTMENT CO.,
Tustin, California.
1920

Deficiency in Tax.....$22,872.09

You are advised that after careful consideration and review, your application under the provisions of Section 327 for assessment of your profits tax as prescribed by Section 328 of Revenue Act of 1918 has been allowed. Your profits tax is based upon a comparison with a group of representative concerns which in the aggregate may be said to be engaged in a like or similar trade or business to that of your company.

The result of the audit under the above-mentioned provisions is as follows: [38]

Net income as shown by Bureau letter dated November 2, 1922		$184,137.82	
Less: Interest on Obligations of the U. S. not exempt	$ 347.41		
Profits tax (Section 328)	20,522.92		$20,522.92
Exemption	2,000.00	22,870.33	
Taxable at 10%		$161,267.49	16,126.75
Total tax assessable			$36,649.67
Tax Assessed, Account #400606			13,777.58
Deficiency in Tax			$22,872.09

[39]

[Endorsed]: United States Board of Tax Appeals. Filed Sept. 10, 1925.

[Title of Court and Cause—Docket No. 6989.]

ANSWER.

Comes now the Commissioner of Internal Revenue, by his attorney, A. W. Gregg, Solicitor of Internal Revenue, and for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

(1) Admits the statements contained in paragraphs 1, 2 and 3 of the petition.

(2) Admits that the taxpayer is engaged in the cultivation of citrus fruits and nuts.

(3) Admits that the taxpayer was organized as a corporation on or about October 5, 1906, with a paid-in capital stock of $81,000.

(4) Admits that the taxpayer leased from the Irvine Company 1,000 acres of land for a term of 10 years beginning on or about December 1, 1906 and ending on or about November 30, 1916.

(5) Admits that the taxpayer had an option to purchase the said 1,000 acres of land at a price of $200.00 per acre. [40]

(6) Admits that the taxpayer operated under this lease as claimed in the taxpayer's petition.

(7) Admits that on November 30, 1916, the taxpayer exercised its option under its agreement and

purchased the said 1,000 acres of land, together with the improvements thereon, for the agreed sum of $200,000.00 and that that consideration was paid and payable as specified in the taxpayer's petition.

(8) Admits that the Commissioner in the computation of the taxpayer's invested capital for the taxable years involved, allowed only $200,000.00 representing the cost of the land, together with the improvements thereon.

(9) Admits that the Commissioner in determining the taxpayer's depreciation predicated the amount of depreciation allowable upon the basis of the cost of the land and improvements thereon of $200,000.00.

(10) Denies that the cost to the taxpayer of the 1,000 acres of land, together with the improvements thereon, was in excess of $200,000.00.

(11) Denies that on the date the taxpayer exercised its option to purchase the 1,000 acres of land, together with improvements thereon for a purchase price of $200,000.00, that the appraised value of the land, together with improvements thereon, was $1,854,000.00, or, that if it were, it is material or relevant to the issue in controversy.

(12) Denies that the cost of the depreciable assets as determined by the Commissioner is not the true cost thereof.

(13) Denies that the appraised value of the de- [41] preciable assets on the 1,000 acres of land

was $1100.00 per acre, or, that if it were, it is material or relevant to the issue in controversy.

(14) Denies that the March 1, 1913 value of the orchard trees on the land was $1,115.00 per acre, or, that if it were, it is material or relevant to the issue in controversy.

(15) Denies generally and specifically each and every allegation contained in taxpayer's petition not hereinbefore admitted, qualified or denied.

PROPOSITIONS OF LAW.

(1) Only the cost of an asset purchased by a taxpayer may be included in the taxpayer's assets in the determination of the taxpayer's invested capital under the provisions of Sections 325-326 of the Revenue Act of 1918.

(2) Appreciation of an asset purchased under an option agreement, which appreciation occurs from the date the option is taken to the date of the exercise thereof, does not constitute either paid-in surplus or earned surplus.

(3) Depreciation may be predicated only upon the cost of property acquired subsequent to March 1, 1913.

(4) The Commissioner has allowed a reasonable amount of depreciation as a deduction.

(5) The taxpayer is not entitled to any other or further relief in the determination of its profits tax for the year 1920 than has been allowed by the Commissioner. [42]

WHEREFORE, it is prayed that the taxpayer's petition be dismissed and the appeal denied.

A. W. GREGG,
Solicitor of Internal Revenue,
Attorney for Commissioner of Internal Revenue.

Of Counsel:
WARD LOVELESS,
Special Attorney,
Bureau of Internal Revenue.

WL/mvb.

[Endorsed]: United States Board of Tax Appeals. Filed Oct. 1, 1925.

[Title of Court and Cause—Docket No. 6989.]

MOTION FOR LEAVE TO AMEND.

Comes now the above-named petitioner, by its attorneys, and moves the Board that it be granted permission to amend and file its petition in accord-
[43] ance with the completed amended petitions attached hereto.

(Signed) DANA LATHAM
DANA LATHAM,
Title Insurance Building,
Los Angeles, Calif.

(Signed) F. O. GRAVES
F. O. GRAVES,
c/o Miller & Chevalier,
Southern Bldg.,
Washington, D. C.
Of Counsel.

Motion dated April 2, 1928.
Granted Apr. 5. 1928.
(Signed) B. H. LITTLETON,
Member, U. S. Board of Tax Appeals.

[Endorsed]: United States Board of Tax Appeals. Filed Apr. 4, 1928.

[Title of Court and Cause—Docket No. 6989.] [44]

AMENDED PETITION.

The above-named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter (IT:E.SM. -CLB.-C584-60D.) dated July 27, 1925, and as the basis of its appeal sets forth the following:

1. The petitioner is a California corporation which was organized on or about July 24, 1922 and which was not in existence during the taxable year 1920.

2. The deficiency letter (copy of which is attached and marked Exhibit "A") was mailed to the petitioner on July 27, 1925.

3. The taxes in controversy are not taxes of your petitioner but appear to be income and profits taxes for the calendar year 1920, assessable, if at all, against the San Joaquin Fruit Company, a corporation other than the corporation to whom the aforesaid deficiency letter was addressed, and are more than $10,000.00 to wit: $22,872.09 for the calendar year 1920.

4. The determination of tax contained in the said deficiency letter is based upon the following errors:

(a) That the petitioner was not in existence during the year in question and hence could not be liable as a taxpayer for any alleged deficiency;

(b) That the San Joaquin Fruit Company was dissolved as a corporation during the year 1922 and

its existence was then and there terminated; [45]

(c) That the deficiency letter in question was received by the petitioner during the year 1925, prior to the passage of the Revenue Act of 1926, and that under the provisions of the Revenue Act of 1924 there can be no liability upon the petitioner as a transferee of assets for taxes alleged to be due from a transferor, even though it should be assumed that Section 280 of the Revenue Act of 1926 is constitutional and is applicable to the facts herein involved;

(d) That the Commissioner is attempting to exercise judicial power in violation of Section 1 of Article 3 of the Constitution of the United States;

(e) That said Section 280 is without retroactive application to a transfer completed before the effective date of said Section 280;

(f) That upon information and belief petitioner alleges there is no tax liability due from the San Joaquin Fruit Company for the year 1920, for the following reasons:

(1) That the Commissioner failed and refused to permit the San Joaquin Fruit Company to include in its invested capital for the calendar year 1920 the sum of $1,659,372.85, which represents the disallowance of surplus arising from a closed transaction which occurred on November 30, 1916, on which date the San Joaquin Fruit Company exercised an option to acquire certain improved real estate, which option had been acquired on October 13, 1906, and had steadily and continuously increased in value through the ten-year period and

on the date of its exercise had a market value of $1,659,372.85. [46]

(2) That the Commissioner has failed and refused to permit the San Joaquin Fruit Company to deduct depreciation for the year 1920 based on the value of fruit-trees at November 30, 1916, on which date title to the trees was acquired by the San Joaquin Fruit Company by exercise of said option.

(3) That the Commissioner has failed and refused to permit the San Joaquin Fruit Company to deduct depreciation for the year 1920 based on a March 1, 1913, value of fruit-trees included in a leasehold and option owned by the San Joaquin Fruit Company on March 1, 1913, which leasehold and option were converted into fee-simple ownership on November 30, 1916.

(4) That although the Commissioner has determined the San Joaquin Fruit Company's income and profits tax liability for the year 1920 under the provisions of Sections 327 and 328 of the Revenue Act of 1918 the corporations selected by the Commissioner for this purpose under the provisions of Section 328 did not constitute representative corporations engaged in the same line of business.

(g) That upon information and belief petitioner alleges that the statute of limitations has run against the collection of any deficiency in tax for the year in question from the San Joaquin Fruit Company, in that no assessment was made nor any deficiency letter mailed to it within five years after the return was filed by it for the taxable year 1920.

(h) That the statute of limitations has run against the collection of any deficiency in tax for the year in question from the petitioner under the [47] provisions of Section 280 of the Revenue Act of 1926, or any other applicable provision of law, in that no assessment of liability as a transferee of property of the taxpayer, San Joaquin Fruit Company, a corporation, or otherwise or at all, was made or levied within one year after the expiration of the period of limitation for assessment against the said San Joaquin Fruit Company.

(i) That the Commissioner of Internal Revenue was, and is, without jurisdiction of the subject matter of an alleged liability of petitioner, either as an alleged taxpayer or as an alleged transferee of assets, in the premises.

5. The facts upon which the petitioner relies as the basis of this proceedin are as follows:

(a) The San Joaquin Fruit Company was organized on or about October 5, 1906. During the period from December 1, 1906, until its dissolution on December 26, 1922, it was engaged in the orchard business. The San Joaquin Fruit and Investment Company, which was incorporated on or about July 24, 1922, acquired the operating properties of the San Joaquin Fruit Company in exchange for stock on or about November 6, 1922, but assumed no liabilities of the San Joaquin Fruit Company at this or any other date.

(b) The San Joaquin Fruit Company made Federal income and profits tax returns for the cal-

endar year 1920 on, to-wit: March 15, 1921. Thereafter the Commissioner of Internal Revenue caused the books of the San Joaquin Fruit Company to be examined by an Internal Revenue Agent and as a [48] result of this examination asserted an additional tax liability on the part of the said San Joaquin Fruit Company for the year in question. Thereafter, a series of conferences was held in Washington, D. C., in the offices of the Internal Revenue Bureau followed by the issuance by the Commissioner of a so-called deficiency letter for the year 1920 dated July 27, 1925. Said deficiency letter was addressed to the San Joaquin Fruit and Investment Company. Within the period prescribed by law within which to file an appeal, the San Joaquin Fruit and Investment Company filed a petition with the United States Board of Tax Appeals covering the year 1920, in which it set forth certain facts relating to the San Joaquin Fruit Company.

(c) The San Joaquin Fruit Company was engaged in the cultivation and sale of citrus fruits and nuts. During the year 1920 it owned in fee simple 1,000 acres of real estate of which 600 acres were planted to walnut trees and 400 acres to orange trees. The corporation was organized October 5, 1906, with a paid-in capital of $81,000.00. The entire capital stock was issued in equal parts to C. E. Utt, Sherman Stevens and James Irvine. The stock issued to James Irvine was shortly afterwards transferred to the Irvine Company. The Irvine Company (referred to hereinafter as the lessor) leased

to the San Joaquin Fruit Company for a term of ten years, beginning December 1, 1906, and ending November 30, 1916, 1,000 acres of land [49] situated in Orange County, California, upon the following terms:

1. The San Joaquin Fruit Company should, at its own expense, set out and plant within four years from the date thereof, all the said land in fruit-trees of various varieties and should properly care for irrigating and cultivating the same and replace all trees that died during the ten-year term of the lease.

2. The San Joaquin Fruit Company should also, at its own expense, and during the said term, cultivate crops of grain, beans, peanuts or other products on such portions of land as could be cultivated without material injury to the trees, and prepare such crops for the market at its own expense.

3. A quarter share of said crops including nuts and fruits should be paid to the lessor by the San Joaquin Fruit Company as rental.

4. The San Joaquin Fruit Company should agree to use every reasonable means to prevent the growth and spread of obnoxious weeds, and under certain conditions if such weeds were not checked, the crop rental was increased to one-half the average total amount produced per acre.

5. The San Joaquin Fruit Company should not assign said lease or sublet any portion of the leased premises without the written consent of the lessor.

6. The San Joaquin Fruit Company should, at its own expense, sink wells upon adjacent property

owned by the lessor and develop sufficient water for the irrigation of all crops and trees grown upon said [50] land, and construct at its own cost pipelines to conduct the water developed thereby to the said leased land, an option to purchase the lands whereon water had been developed by the San Joaquin Fruit Company being granted by the lessor.

7. Upon satisfaction of all the conditions of the lease the San Joaquin Fruit Company should have the option to purchase any part or all of the leased lands on the last day of the lease at $200.00 per acre, payable ¼ cash on the exercise of the option and the balance in two equal payments within five years after date of purchase, the deferred payments to bear interest at 6% per annum.

8. In the event that the San Joaquin Fruit Company should not exercise its option to purchase said leased lands, then upon the expiration of the term of the lease, the lessor should have the option of purchasing from the San Joaquin Fruit Company its entire water system and the water developed, upon the payment of the actual cost thereof, less depreciation.

9. The lease also provided that at any time after the entire 1,000 acres were set out to trees, and before the expiration of the lease, the San Joaquin Fruit Company might purchase not to exceed ½ of the said leased lands upon the payment to the lessor of $200.00 per acre cash; but if such option were exercised then the option to purchase the balance of the land at the expiration of the lease was terminated.

10. After the expiration of the term of the lease, [51] said option should cease and terminate as to the portion of said lands not purchased thereunder.

11. During the terms of the lease all taxes upon the real estate were payable by the lessor and all taxes upon the improvements were payable by the San Joaquin Fruit Company.

In accordance with the terms of the above contract the San Joaquin Fruit Company took possession of the leased property on or about November 1, 1906. The land at this time was dry and unirrigated. A portion of it had been previously grown to crops of grain and beans but the remainder was still covered with cactus. Within six months' time the San Joaquin Fruit Company cleared the land, filled in gulches, leveled the property for irrigation and set out 740 acres to trees. Before the end of the first year the irrigating system was so far advanced that water was being delivered to the highest portion of the land. Before the end of the third year the remaining 260 acres of land were planted to orchard trees.

During the ten-year period covered by the lease the entire time of two of the stockholders, Messrs. Utt and Stevens, was devoted to the affairs of the corporation, for which they received no compensation except nominal salaries of $100.00 per month each in the nature of drawing accounts for living expenses.

Before the expiration of the lease the property had been highly improved, including the installation

of a complete underground irrigation system, electric lights and electric power, modern houses [52] and rooms, dining-room for employees, maintenance of a large automobile bus for the benefit of school children, postoffice for employees and the employment of a gardener to maintain the appearance of the property immediately adjacent to the ranch headquarters.

On November 30, 1916, the San Joaquin Fruit Company's option to purchase the property was exercised and the first payment of $75,000.00 provided by the contract was made. The second and final payments of $50,000.00 and $75,000.00 were made on December 31, 1917 and October 28, 1918 respectively.

On November 30, 1916, the value of the real estate and trees thus acquired by the corporation was $1,854,000.00 as determined by independent appraisal.

In its original return for the year 1920 the San Joaquin Fruit Company claimed as a part of its invested capital a paid-in surplus of $1,554,530.07 which represents the difference between the sum of $200,000.00 paid in cash as a portion of the purchase price of the property on November 30, 1916, and the value placed by the corporation on the real estate and trees on that date. Under date of January 25, 1922, the company revised its claim on the basis of independent appraisals and sought to obtain paid-in surplus in the sum of $1,659,372.85. The report of an Internal Revenue Agent dated November 14, 1921 disallowed the claim for paid-in surplus and the

action of the examining agent in this respect was upheld by the Income Tax [53] Unit. The application of the San Joaquin Fruit Company for a hearing before the Solicitor of Internal Revenue was denied by the Income Tax Unit and the final computations set forth in the Internal Revenue Bureau's letter of July 21, 1925, make no allowance for any portion of the paid-in surplus claimed by the San Joaquin Fruit Company.

Upon the exercise of said option, and ever since San Joaquin Fruit Company has had, and is entitled to include in its invested capital, earned surplus and undivided profits amounting to not less than $1,659,372.85 arising from the conversion of capital assets.

(d) In its original return for the year 1920 the San Joaquin Fruit Company deducted depreciation of $59,710.96 covering depreciation of its physical properties including trees. This deduction was reduced to $58,135.69 by the Revenue Agent, but the Commissioner eliminated the major portion of the depreciation deduction applicable to the San Joaquin Fruit Company's orchard trees and did not give effect to the value of these assets at date of acquisition in establishing the deduction for depreciation. Said value as determined by independent appraisal was $1,100 per acre and the life of the trees was approximately 25 years from November 30, 1916.

(e) The value of the orchard trees leased on the San Joaquin Fruit Company on March 1, 1913

and to which title was acquired by it on November 30, 1916, was $1,115.00 per acre. In the [54] report of the Internal Revenue Agent dated November 14, 1921, referred to hereinabove, depreciation on orchard trees at the rate of 3% was allowed upon a value of $1,115.00 per acre, which the agent upon investigation found to be conservative based on a life of 33 1/3 years. In computing the depreciation deduction based on the 1913 value the agent erred in using the rate of 3% for the reason that of the estimated life of the trees approximately five years had elapsed prior to March 1, 1913. Consequently the annual rate of depreciation based on the 1913 value should be increased to 3½%. However, the Income Tax Unit refused to consider the value at March 1, 1913, in establishing tree depreciation for the reason that title to the property was not acquired by the San Joaquin Fruit Company until November 30, 1916. As indicated hereinabove, the San Joaquin Fruit Company owned a property right on March 1, 1913, which was exchanged for a greater property right on November 30, 1916; but the Commissioner has not given effect either to the value of property rights at March 1, 1913, or November 30, 1916, in establishing the depreciation deduction.

(f) The San Joaquin Fruit Company's application for assessment under the provisions of Sections 327 and 328 of the Revenue Act of 1918 was favorably entertained by the Commissioner, who determined that abnormalities of invested capital were present for the year 1920 entitling the San

Joaquin Fruit Company to assessment under these sections. A careful and diligent inquiry discloses [55] the fact that the representative companies whose circumstances were similar to the San Joaquin Fruit Company during the year in question failed to pay the rate of excess profits tax stated by the Commissioner to constitute the fair comparative rate.

All facts stated hereinabove which relate to the San Joaquin Fruit Company are, for the purpose of this petition, stated to be upon information and belief, because the San Joaquin Fruit Company, a dissolved corporation, was the real taxpayer and not the petitioner.

WHEREFORE, the petitioner prays that this Board may hear the proceeding and hold as follows:

(a) That no deficiency in tax on the part of the San Joaquin Fruit and Investment Company as a taxpayer exists for the year in question.

(b) That no deficiency in tax, nor any liability, on the part of the San Joaquin Fruit and Investment Company as a transferee exists for the year in question.

(c) That the Commissioner of Internal Revenue is without jurisdiction as hereinabove alleged.

(d) That assessment of the taxes in controversy against San Joaquin Fruit Company, a corporation, is barred by limitation of time, under Section 277 of the Revenue Act of 1926.

(e) That assessment of any alleged liability against petitioner as a transferee of property of said taxpayer is barred by limitation of time under Section 280 of the Revenue Act of 1926. [56]

(f) That no tax liability is due from the San Joaquin Fruit Company for the following reasons:

(1) That the San Joaquin Fruit Company is entitled to paid-in surplus in the sum of $1,659,372.85 for the calendar year 1920.

(2) That the San Joaquin Fruit Company is entitled to depreciation for the year 1920 based on the November 30, 1916 value of its orchard trees.

(3) That the San Joaquin Fruit Company is entitled to depreciation for the year 1920 based on the March 1, 1913, value of its leasehold and option.

(4) That the San Joaquin Fruit Company is entitled to additional relief for the year 1920 under the provisions of Sections 327 and 328 of the Revenue Act of 1918.

(g) That judgment of this Board be entered herein in favor of petitioner.

(Signed) N. L. McLAREN.
N. L. McLAREN, C. P. A.,
444 California Street,
San Francisco, California,

(Signed) GEORGE M. NAUS.
GEORGE M. NAUS, Atty.-at-Law,
582 Market Street,
San Francisco, California,

(Signed) DANA LATHAM.
DANA LATHAM, Atty.-at-Law,
Title Insurance Building,
Los Angeles, California,
Counsel for Petitioner. [57]

State of California,
County of Orange,—ss.

C. E. Utt, being duly sworn, says that he is the President of the San Joaquin Fruit & Investment Company, successor to the San Joaquin Fruit Company, the petitioner above named, and as such President is duly authorized to verify the foregoing petition. That he has read the foregoing petition or had the same read to him and is familiar with the statements contained therein and that the facts stated are true, except as to those facts stated to be upon information and belief and those facts he believes to be true.

C. E. UTT.

Subscribed and sworn to before me this 23d day of March, 1928.

[Seal] W. S. LEINBERGER,
Notary Public.

My commission expires Aug. 16, 1928.

EXHIBIT "A."
TREASURY DEPARTMENT,
Washington.

July 27, 1925.

IT:E:SM.
CLB.—C584—60D.
San Joaquin Fruit and Investment Co.,
Tustin, California.

Sirs: An audit of your income and profits tax return for the year ended December 31, 1920, has

[58] resulted in the determination of a deficiency in tax of $22,872.09 as shown in Bureau letter dated June 16, 1925.

(Here follows regular 60-day letter.)

Respectfully,
D. H. BLAIR,
Commissioner.
By (Signed) C. B. ALLEN,
Acting Deputy Commissioner.

Enclosures:
Statements.
Agreement—Form A.

IT:E:SM.
CLB.—C584—60D.

SAN JOAQUIN FRUIT AND INVESTMENT CO.
Tustin California.

Year Involved	Deficiency in Tax
Calendar year 1920	$22,872.09

No additional information having been submitted relative to your application for the assessment of your profits tax for the calendar year 1920 under the provisions of Section 328 of the *Revenue of* 1918, the Bureau holds that the action of the Unit as set forth in Bureau letter dated June 16, 1925, is correct and should be sustained. [59]

TREASURY DEPARTMENT,
Washington.

June 16, 1925.

IT:E:SM.
CLB.—C—584.
San Joaquin Fruit and Investment Co.,
Tustin, California.

Sirs: An audit of your income and profits tax return for the year ended December 31, 1920, has resulted in the determination of a deficiency in tax of $22,872.09 as shown in the attached statement.

(Here follows regular 30-day letter.)

Respectfully,
J. G. BRIGHT,
Deputy Commissioner.
By (Signed) I. T. ENES,
Chief of Section.

STATEMENT.

In re: SAN JOAQUIN FRUIT & INVESTMENT CO.
Tustin, California.

1920.

Deficiency in Tax.....$22,872.09

You are advised that after careful consideration and review, your application under the provisions of Section 327 for assessment of your profits tax as prescribed by Section 328 of the Revenue Act of

1918 has been allowed. Your profits tax is based [60] upon a comparison with a group of representative concerns which in the aggregate may be said to be engaged in a like or similar trade or business to that of your company.

The result of the audit under the above mentioned provisions is as follows: [61]

Net income as shown by Bureau letter dated November 2, 1922		$184,137.82	
Less: Interest on Obligations of the U. S. not exempt	$ 347.41		
Profits tax (Section 328)	20,522.92		$20,522.92
Exemption	2,000.00	22,870.33	
Taxable at 10%		$161,267.49	16,126.75
Total tax assessable			$36,649.67
Tax assessed, Account #400606			13,777.58
Deficiency in Tax			$22,872.09

[62]

[Title of Court and Cause—Docket No. 6989.]

ANSWER TO AMENDED PETITION.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the amended petition of the above-named taxpayer, admits and denies as follows:

1. Denies the allegations in paragraph 1.

2. Admits the allegations in paragraph 2.

3. Answering the allegations in paragraph 3, he admits that the taxes in controversy are for the calendar year 1920. Denies the remaining allegations in paragraph 3.

5. (a) Answering the allegations in paragraph 5, (a), he admits that the San Joaquin Fruit Co. was organized on or about October 5, 1906. Denies the remaining allegations in paragraph 5, (a).

5. (b) Answering the allegations in paragraph 5, (b), he admits that a deficiency letter was addressed to the San Joaquin Fruit & Investment Co. on or about July 27, 1925. He further admits [63] that within the period prescribed by law within which to file an appeal, said San Joaquin Fruit & Investment Co. filed a petition with the United States Board of Tax Appeals covering the year 1920. Denies the remaining allegations in paragraph 5, (b).

5. (c) For lack of information upon which to base a belief, denies the allegations in paragraph 5, (c).

5. (d), (e) Denies the allegations in paragraphs 5, (d) and (e).

5. (f) Answering the allegations in paragraph 5, (f), he admits that taxpayer has been accorded special assessment. Denies the remaining allegations in paragraph 5, (f).

Denies generally and specifically each and every allegation in taxpayer's amended petition not hereinbefore expressly admitted, qualified or denied, and respondent further says that petitioner should not be heard to assert that it is not the taxpayer in this case, for the reason that the original petition was filed September 10, 1925, in which original petition the taxpayer asserted that it was formerly the San Joaquin Fruit & Investment Co. implying thereby that San Joaquin Fruit & Investment Co. was merely a change in name. Respondent further says that heretofore, to wit, on May 3, 1927, the taxpayer did engage in the trial on the merits of its case in so far as questions other than special assessment were concerned and that it should not therefore be now heard to assert that it is not the taxpayer involved in this appeal. **[64]**

WHEREFORE, it is prayed that the amended petition be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
JOHN D. FOLEY,
Special Attorney,
Bureau of Internal Revenue.

jaf/7/9/28.

[Endorsed]: United States Board of Tax Appeals. Filed Jul. 9, 1928.

United States Board of Tax Appeals

Docket No. 20,801

SAN JOAQUIN FRUIT AND INVESTMENT CO. (Formerly SAN JOAQUIN FRUIT CO.,)
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent. [65]

PETITION.

The above-named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:E:SM-60D-HMW-D-29804) dated September 1, 1926, and as the basis of its proceeding alleges as follows:

1. The taxpayer is a California corporation with principal office in the city to Tustin, California.

2. The notice of deficiency (copy of which is attached marked Exhibit "A," together with copy of Bureau letter dated July 20, 1926, marked Exhibit "B," referred to therein) was mailed to the taxpayer on September 1, 1926.

3. The taxes in controversy are income and profits taxes for the calendar year 1921 and for $21,867.40.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) That the Commissioner has refused to permit the taxpayer to include in its invested capital for the year 1921 the sum of $1,659,372.85 which represents a disallowance of surplus arising from a closed transaction which occurred on November 30, 1916, on which date the taxpayer exercised an option to acquire improved real estate, which option had been obtained on October 13, 1906, and had steadily and continuously increased in value through the ten year period, and on the date of its exercise had a market value of $1,659,372.85. [66]

(b) That the Commissioner has refused to permit the taxpayer to take a depreciation deduction for the year 1921 based on the value of fruit-trees at November 30, 1916, on which date title to the trees was acquired by the taxpayer, by exercise of said valuable option.

(c) That the Commissioner has refused to permit the taxpayer to take a depreciation deduction for the year 1921 based on a March 1, 1913, value of fruit-trees included in a leasehold and option owned by the taxpayer on March 1, 1913, which leasehold and option was converted into fee-simple ownership on November 30, 1916.

(d) That although the Commissioner has determined the taxpayer's income and profits tax liability for the year 1921 under the provisions of Sections 327 and 328 of the Revenue Act of 1918 the corporations selected by the Commissioner for this purpose under the provisions of Section 328 did not constitute representative corporations engaged in the same line of business.

5. The facts upon which the taxpayer relies as the basis of this proceeding are as follows:

(A) The taxpayer is engaged in the cultivation and sale of citrus fruits and nuts. During the year 1921 it owned in fee simple 1,000 acres of real estate of which 600 acres were planted to walnut trees and 400 acres to orange trees. The corporation was organized October 5, 1906, with a Paid-in Capital of $81,000.00. The entire capital stock was issued in equal parts to C. E. Utt, Sherman Stevens and James Irvine. The stock issued to James Irvine [67] was shortly afterwards transferred to the Irvine Company.

The Irvine Company (referred to hereinafter as the lessor) leased to the taxpayer for a term of ten years, beginning December 1, 1906, and ending November 30, 1916, 1,000 acres of land situated in Orange County, California, upon the following terms:

1. The taxpayer should, at its own expense, set out and plant within four years from the date thereof, all the said land in fruit trees of various varieties and should properly care for irrigating and cultivating the same and replace all trees that died during the ten year term of the lease.

2. The taxpayer should also at its own expense, and during the said term, cultivate crops of grain, beans, peanuts or other products on such portions of land as could be cultivated without material injury to the trees, and prepare such crops for the market at its own expense.

3. A quarter share of said crops including nuts and fruits should be paid to the lessor by the taxpayer as rental.

4. The taxpayer should agree to use every reasonable means to prevent the growth and spread of obnoxious weeds, and under certain conditions if such weeds were not checked, the crop rental was increased to one-half the average total amount produced per acre.

5. The taxpayer should not assign said lease or submit any portion of the leased premises without the written consent of the lessor. [68]

6. The taxpayer should at its own expense, sink wells upon adjacent property owned by the lessor and develop sufficient water for the irrigation of all crops and trees grown upon said land and construct at its own cost pipe-lines to conduct the water developed thereby to the said leased land, an option to purchase the lands whereon water had been developed by the taxpayer being granted by the lessor.

7. Upon satisfaction of all the conditions of the lease the taxpayer should have the option to purchase any part or all of the lease lands on the last day of the lease at $200.00 per acre, payable ¼ cash on the exercise of the option and the balance in two equal payments within five years after date of purchase, the deferred payments to bear interest at 6% per annum.

8. In the event that the taxpayer should not exercise its option to purchase said leased lands, then upon the expiration of the term of the lease, the lessor should have the option of purchasing from the taxpayer its entire water system and the water developed, upon the payment of the actual

9. The lease also provided that at any time after the entire 1,000 acres were set out to trees, and before the expiration of the lease, the taxpayer might purchase not to exceed ½ of the said leased lands upon the payment to the lessor of $200.00 per acre cash; but if such option were exercised then the option to purchase the balance of the land at the expiration of the lease was terminated.

10. After the expiration of the term of the lease, [60] said option should cease and terminate as to the portion of said lands not purchased thereunder.

11. During the terms of the lease all taxes upon the real estate were payable by the lessor and all taxes upon the improvements were payable by the taxpayer.

In accordance with the terms of the above contract the taxpayer corporation took possession of the leased property on or about November 1, 1906. The land at this time was dry and unirrigated. A portion of it had been previously grown to crops of grain and beans, but the remainder was still covered with cactus. Within six months' time the taxpayer cleared the land, filled in gulches, leveled the property for irrigation and set out 740 acres to trees. Before the end of the first year the irrigating system was so far advanced that that water was being delivered to the highest portion of the land. Before the end of the second year the remaining 260 acres of land were planted to orchard trees.

During the ten year period covered by the lease the entire time of two of the stockholders, Messrs. Utt and Stevens, was devoted to the affairs of the

corporation for which they received no compensation except nominal salaries of $100.00 per month, in the nature of drawing accounts for living expenses.

Before the expiration of the lease the property had been highly improved, including the installation of a complete underground irrigation system, electric lights and electric power, sewer system, high pressure fire equipment, modern houses and rooms, [70] dining-room and general store for employees, maintenance of a large automobile bus for the benefit of school children, postoffice for employees and the employment of a gardener to maintain the appearance of the property immediately adjacent to the ranch headquarters.

On November 30, 1916, the taxpayer's option to purchase the property was exercised and the first payment of $75,000.00 provided by the contract was made. The second and final payments of $50,000.00 and $75,000.0 were made on December 31, 1917, and October 28, 1918, respectively.

On November 3, 1916, the value of the real estate and trees thus acquired by the corporation was $1,854,000.00 as determined by independent appraisal.

In its original return for the year 1921 the taxpayer claimed as a part of its invested capital a Paid-in Surplus of $1,569,372.85 which, subject to minor adjustments, represents the difference between the sum of $200,000.00 paid in cash as a portion of the purchase price of the property on No-

vember 30, 1916, and the value placed by the taxpayer on the real estate and trees on that date. The Commissioner of Internal Revenue disallowed the claim for Paid-in Surplus following the examination of an Internal Revenue Agent. The final computations as set forth in the Internal Revenue Bureau's letter of July 20, 1926, make no allowance for any portion of the Paid-in Surplus claimed by the taxpayer.

Upon the exercise of said option, and ever since, the taxpayer corporation has had, and is entitled [71] to include in its invested capital, earned surplus and undivided profits amounting to not less than $1,659,372.85 arising from the conversion of capital assets.

(B) In its original return for the year 1921 the taxpayer deducted $..... covering depreciation of its fixed assets. The value of the orchard trees at date of their acquisition by the corporation was $1,100 per acre and the life of the trees was approximately 25 years from November 30, 1916. The Commissioner eliminated the major portion of the depreciation deduction applicable to the taxpayer's orchard trees for the year 1921 and did not give effect to the value of these assets at date of acquisition in establishing the deduction for depreciation.

(C) The value of the orchard trees leased to the taxpayer on March 1, 1913, and to which title was acquired by the taxpayer on November 30, 1916, was $1,115.00 per acre. The Commissioner of In-

ternal Revenue refused to consider the value at March 1, 1913, in establishing tree depreciation for the reason that title to the property was not acquired by the taxpayer until November 30, 1916. As indicated hereinabove, the taxpayer owned a property right on March 1, 1913, which was exchanged for a greater property right on November 30, 1916, but the Commissioner has not given effect either to the value of property rights at March 1, 1913, or November 30, 1916, in establishing the depreciation deduction. [72]

(D) The taxpayer's application for assessment under the provisions of Sections 327 and 328 of the Revenue Act of 1918 was favorably entertained by the Commissioner, who determined that abnormalities of invested capital were present for the year 1921 entitling the taxpayer to assessment under these sections. A careful and diligent inquiry discloses the fact that the representative companies whose circumstances were similar to the taxpayer during the years in question failed to pay the rate of excess profits tax stated by the Commissioner to constitute the fair comparative rate.

WHEREFORE, the petitioner prays that this Board may hear the proceeding and hold as follows:

(A) That the petitioner is entitled to earned Paid-In Surplus in the sum of $1,659,372.85 in the computation of its invested capital for the year 1921.

(B) That the petitioner is entitled to depreciation for the year 1921 based on the November 30, 1916, value of its orchard trees.

(C) That the petitioner is entitled to depreciation for the year 1921 based on the March 1, 1913, value of its leasehold and option.

(D) That the petitioner is entitled to additional [73] relief under the provisions of Section 328 of the Revenue Act of 1918.

N. L. McLAREN, C. P. A.
444 California Street,
San Francisco, California,
GEORGE M. NAUS,
Attorney at Law,
Central Bank Building,
Oakland, California,
Counsel for Petitioner.

State of California,
County of Orange.—ss.

C. E. Utt, being duly sworn, says that he is the President of the San Joaquin Fruit and Investment Company, successor to the San Joaquin Fruit Company, the petitioner above named, and as such President is duly authorized to verify the foregoing petition. That he has read the foregoing petition or had the same read to him and is familiar with the statements contained therein and that the facts stated are true, except as to those facts stated to be upon information and belief and those facts he believes to be true.

(Signed) C. E. UTT.

Subscribed and sworn to before me this 16 day of October, 1926.

(Signed) M. S. LEINBERGER,
Notary Public. [74]

EXHIBIT "A."

Form NP—2.

TREASURY DEPARTMENT,
Washington, D. C.

Office of
Commissioner of Internal
Revenue.

September 1, 1926.

IT:E:SM-60D.
HMW-D-29804.
San Joaquin Fruit Company,
c/o San Joaquin Fruit and Investment
Company,
Tustin, California.

Sirs:

An audit of your income and profits tax return for the calendar year 1921 has resulted in the determination of a deficiency in tax of $21,867.40 as shown in Bureau letter dated July 20, 1926.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days [75] prescribed and an assessment has been

made or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:E:SM-60D-HMW-D-29804.

In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,
D. H. BLAIR,
Commissioner.

By .....,
Assistant to the Commissioner.

Inclosures:
Form A.
" 882. tel-1. [76]

EXHIBIT "B."

Form NP—1.

TREASURY DEPARTMENT,
Washington, D. C.

Office of
Commissioner of Internal
Revenue.

July 20, 1926.

1T-E-SM.
HMW-D-29804.
San Joaquin Fruit Company,
c/o San Joaquin Fruit and Investment
Company,
Tustin, California.

Sirs:

An audit of your income and profits tax return for the year ended December 31, 1921, has resulted in the determination of a deficiency in tax of $21,-867.40, as shown the attached statement.

You are granted 30 days from the date of this letter within which to present a protest against the deficiency proposed herein. The protest and any additional statement of facts must be executed in triplicate, under oath, and contain the following information:

(a) The name and address of the taxpayer (in the case of an individual the residence, and in the case of a corporation the principal office or place of business); (b) in the case of a corporation the name of the State of incorporation; (c) the designation by date and symbol of the letter advising of [77] the proposed deficiency with respect to which

the protest is made; (d) the designation of the year or years involved and a statement of the amount of tax in dispute for each year; (3) an itemized schedule of the findings to which the taxpayer takes exception; (f) a summary statement of the grounds upon which the taxpayer relies in connection with each exception; and (g) in case the taxpayer desires a hearing, a statement to that effect.

If a protest is filed, any additional evidence or briefs of argument submitted will be given careful consideration, and if the Commissioner finally determines that there is a deficiency, you will be advised thereof by registered mail in accordance with the provisions of Section 274 of the Revenue Act of 1926. Should you not agree to the deficiency as finally determined by the Commissioner, you will be allowed 60 days from the date of mailing of the registered letter (not counting Sunday as the sixtieth day) in which to file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

If you acquiesce in the proposed deficiency as shown in this letter and the accompanying statement, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:E:SM HMW-D-29804. In the event that you acquiesce in a part of such deficiency, the waiver should be [78]

executed with respect to the items to which you agree.

Respectfully,
C. R. NASH,
Assistant to the Commissioner.
By .....

Inclosures:
Statement.
Form A.
Form 883.
asc-1.

STATEMENT.

IT:E:SM.
HME.-D-29804.

In re: SAN JOAQUIN FRUIT AND INVESTMENT COMPANY,
Tustin, California.

Year.	Deficiency in Tax.
1921.	$21,867.40

You are advised that after careful consideration and review, your application under the provisions of Section 327 for assessment of your profits tax as prescribed by Section 328 of Revenue Act of 1921 has been allowed. Your profits tax is based upon a comparison with a group of representative concerns which in the aggregate may be said to be engaged in a like or similar trade or business to that of your company.

The result of the audit under the above-mentioned provisions is as follows: [79]

1921.

Profits Tax, Section 328			$19,609.60
Net income as reported by revenue agent		$120,002.33	
Less:			
Interest on U. S. Obligations not exempt	$ 1,085.93		
Profit Tax	19,609.60	20,695.53.	
Balance		$99,306.80	
Tax at 10%			9,930.68
Total tax assessable			$29,540.28
Original tax #401704			7,672.88
Deficiency in Tax			$21,867.40

[80]

A copy of this communication has been forwarded to your authorized representative, McLaren, Goode and Company, San Francisco, California.

Sec—1.

[Endorsed]: United States Board of Tax Appeals. Filed Oct. 25, 1926.

[Title of Court and Cause—Docket No. 20,801.]

ANSWER.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for answer to the taxpayer's petition admits and denies as follows:

1. Admits the allegations of paragraph 1.
2. Admits the allegations of paragraph 2.
3. Admits the allegations of paragraph 3. [81]
4. Denies each and every assignment of error contained in paragraph 4.

5(A). Admits the allegations of the first three sentences of subdivision (A) of paragraph 5.

Admits that the Irvine Company leased certain property to the taxpayer, and calls for the production of said lease at the trial of this cause.

Admits that in accordance with the terms of said lease the taxpayer corporation took possession of the leased property on or about December 1, 1906.

Admits that in its original return for the year 1921 the taxpayer claimed as a part of its invested capital a paid-in surplus of $1,659,372.85, and that

the Commissioner of Internal Revenue disallowed said claim.

San Joaquin Fruit and Investment Company, (formerly San Joaquin Fruit Company), Docket No. 20,801.

(B) Admits that in its original return for the year 1921, the taxpayer deducted $69,240.59 under Schedule A-18 as exhaustion, wear and tear. Admits that of said item the Commissioner disallowed the amount of $42,187.62.

(C) Admits that the Commissioner of Internal Revenue refused to consider the value at March 1, 1913, in establishing tree depreciation and denies such March 1, 1913, value claimed by the petitioner.

(D) Admits that the Commissioner of Internal Revenue accorded the taxpayer consideration under the provisions of Sections 327 and 328 of the Revenue Act of 1918 and the Revenue Act of 1921 and computed its profits tax for said year under said provisions. [82]

Denies individually and collectively each and every allegation of fact properly pleaded in the taxpayer's petition not hereinbefore specifically admitted, qualified or denied.

WHEREFORE, it is prayed that the taxpayer's appeal be denied.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
A. R. MARRS,
Special Attorney,
Bureau of Internal Revenue.

ARM:LMG.

[Endorsed]: United States Board of Tax Appeals. Filed Dec. 27, 1926.

[Title of Court and Cause—Docket No. 20,801.]

[83]

AMENDED PETITION.

The above-named petitioner hereby appeals from the determination of the Commissioner if Internal Revenue set forth in his deficiency letter (IT:E:-SM—60D—HMW—D29804) dated September 1, 1926, and as the basis of its appeal sets forth the following:

1. The petitioner is a California corporation which was organized on or about July 24, 1922, and which was not in existence during the taxable year 1921.

2. The deficiency letter (copy of which is attached and market Exhibit "A") was mailed to the San Joaquin Fruit Company, care of the petitioner, on September 1, 1926.

3. The taxes in controversy are not taxes of your petitioner but appear to be income and profits taxes for the calendar year 1921, assessable, if at all, against the San Joaquin Fruit Company, a corporation other than this petitioner, and are more than $10,000.00 to-wit: $21,867.40 for the calendar year 1921.

4. The determination of tax contained in the said deficiency letter is based upon the following errors:

(a) That the petitioner was not in existence during the year in question and hence could not be liable as a taxpayer for any alleged deficiency asserted under the provisions of Section 274 (d),

Revenue Act of 1926 against the San Joaquin Fruit Company; [84]

(b) That the San Joaquin Fruit Company was dissolved as a corporation during the year 1922 and its existence was then and there terminated;

(c) That the deficiency letter in question was not issued to this petitioner as a transferee of the assets of the San Joaquin Fruit Company as provided by the Revenue Act of 1926;

(d) That the Commissioner is attempting to exercise judicial power in violation of Section 1 of Article 3 of the Constitution of the United States;

(e) That said Section 280 is without retroactive application to a transfer completed before the effective date of said Section 280;

(f) That upon information and belief petitioner alleges there is no tax liability due from the San Joaquin Fruit Company for the year 1921 for the following reasons:

(1) That the Commissioner failed and refused to permit the San Joaquin Fruit Company to include in its invested capital for the calendar year 1921 the sum of $1,659,372.85, which represents the disallowance of surplus arising from a closed transaction which occurred on November 30, 1916, on which date the San Joaquin Fruit Company exercised an option to acquire certain improved real estate, which option had been acquired on October 13, 1906, and had steadily and continuously increased in value through the ten-year period and

on the date of its exercise had a market value of $1,659,372.85.

(2) That the Commissioner has failed and refused to permit the San Joaquin Fruit Company [85] to deduct depreciation for the year 1921, based on the value of fruit-trees at November 30, 1916, on which date title to the trees was acquired by the San Joaquin Fruit Company by exercise of said option.

(3) That the Commissioner has failed and refused to permit the San Joaquin Fruit Company to deduct depreciation for the year 1921, based on a March 1, 1913, value of fruit-trees included in a leasehold and option owned by the San Joaquin Fruit Company on March 1, 1913, which leasehold and option were converted into fee-simple ownership on November 30, 1916.

(4) That although the Commissioner has determined the San Joaquin Fruit Company's income and profits tax liability for the year 1921, under the provisions of Sections 327 and 328 of the Revenue Act of 1921, the corporations selected by the Commissioner for this purpose under the provisions of Section 328 did not constitute representative corporations engaged in the same line of business.

(g) That upon information and belief petitioner alleges that the statute of limitations has run against the collection of any deficiency in tax for the year in question from the San Joaquin Fruit Company, in that no assessment was made nor any

deficiency letter mailed to it within four years after the return was filed by it for the taxable year 1921.

(h) That the statute of limitations has run against the collection of any deficiency in tax for the year in question from the petitioner under the pro- [86] visions of Section 280 of the Revenue Act of 1926, or any other applicable provision of law, in that no assessment of liability as a transferee of property of the taxpayer, San Joaquin Fruit Company, a corporation, or otherwise or at all, was made or levied within one year after the expiration of the period of limitation for assessment against the said San Joaquin Fruit Company.

(i) That the Commissioner of Internal Revenue was, and is, without jurisdiction of the subject matter of an alleged liability of petitioner, either as an alleged taxpayer or as an alleged transferee of assets, in the premises.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) The San Joaquin Fruit Company was organized on or about October 5, 1906. During the period from December 1, 1906, until its dissolution on December 26, 1922, it was engaged in the orchard business. The San Joaquin Fruit and Investment Company, which was incorporated on or about July 24, 1922, acquired the operating properties of the San Joaquin Fruit Company in exchange for stock on or about November 6, 1922, but assumed no liabilities of the San Joaquin Fruit Company at this or any other date.

(b) The San Joaquin Fruit Company filed with the Collector of Internal Revenue for the 6th Collection District of California Federal income and profits tax returns for the calendar year 1921, on, to-wit: May 12, 1922. Thereafter, the Commissioner of Internal Revenue caused the books of the [87] San Joaquin Fruit Company to be examined by an Internal Revenue Agent and as a result of this examination asserted an additional tax liability on the part of the said San Joaquin Fruit Company for the year in question. Thereafter, a series of conferences was held in Washington, D. C., in the offices of the Internal Revenue Bureau followed by the issuance by the Commmissioner of a so-called deficiency letter for the year 1921, dated September 1, 1926. Within the period prescribed by law within which to file an appeal, the San Joaquin Fruit and Investment Company filed a petition with the United States Board of Tax Appeals covering the year 1921, in which is set forth certain facts relating to the San Joaquin Fruit Company.

(c) The San Joaquin Fruit Company was engaged in the cultivation and sale of citrus fruits and nuts. During the year 1920, it owned in fee simple 1,000 acres of real estate of which 600 acres were planted to walnut trees and 400 acres to orange trees. The corporation was organized October 5, 1906, with a paid-in capital of $81,000.00. The entire capital stock was issued in equal parts to C. E. Utt, Sherman Stevens and James Irvine. The stock issued to James Irvine was shortly afterwards transferred to the Irvine Company. The Irvine Com-

pany (referred to hereinafter as the lessor) leased to the San Joaquin Fruit Company for a term of ten years, beginning December 1, 1906, and ending November 30, 1916, 1,000 acres of land situated in Orange County, California, upon the following terms: [88]

1. The San Joaquin Fruit Company should, at its own expense, set out and plant within four years from the date thereof, all the said land in fruit-trees of various varieties and should properly care for irrigating and cultivating the same and replace all trees that died during the ten-year term of the lease.

2. The San Joaquin Fruit Company should also, at its own expense, and during the said term, cultivate crops of grain, beans, peanuts or other products on such portions of land as could be cultivated without material injury to the trees, and prepare such crops for the market at its own expense.

3. A quarter share of said crops including nuts and fruits should be paid to the lessor by the San Joaquin Fruit Company as rental.

4. The San Joaquin Fruit Company should agree to use every reasonable means to prevent the growth and spread of obnoxious weeds, and under certain conditions if such weeds were not checked, the crop rental was increased to one-half the average total amount produced per acre.

5. The San Joaquin Fruit Company should not assign said lease or sublet any portion of the leased premises without the written consent of the lessor.

6. The San Joaquin Fruit Company should, at its own expense, sink wells upon adjacent property

owned by the lessor and develop sufficient water for the irrigation of all crops and trees grown upon said land, and construct at its own cost pipe-lines to conduct the water developed thereby to the said leased land, an option to purchase the lands [89] whereon water had been developed by the San Joaquin Fruit Company being granted by the lessor.

7. Upon satisfaction of all the conditions of the lease the San Joaquin Fruit Company should have the option to purchase any part or all of the leased lands on the last day of the lease at $200.00 per acre, payable ¼ cash on the exercise of the option and the balance in two equal payments within five years after date of purchase, the deferred payments to bear interest at 6 per cent per annum.

8. In the event that the San Joaquin Fruit Company should not exercise its option to purchase said leased lands, then upon the expiration of the term of the lease, the lessor should have the option of purchasing from the San Joaquin Fruit Company its entire water system and the water developed, upon the payment of the actual cost thereof, less depreciation.

9. The lease also provided that at any time after the entire 1,000 acres were set out to trees, and before the expiration of the lease, the San Joaquin Fruit Company might purchase not to exceed ½ of the said leased lands upon the payment to the lessor of $200.00 per acre cash; but if such option were exercised then the option to purchase the balance of

the land at the expiration of the lease was terminated.

10. After the expiration of the term of the lease, said option should cease and terminate as to the portion of said lands not purchased thereunder.

11. During the terms of the lease all taxes upon the real estate were payable by the lessor and all [90] taxes upon the improvements were payable by the San Joaquin Fruit Company.

In accordance with the terms of the above contract the San Joaquin Fruit Company took possession of the leased property on or about November 1, 1906. The land at this time was dry and unirrigated. A portion of it had been previously grown to crops of grain and beans but the remainder was still covered with cactus. Within six months' time the San Joaquin Fruit Company cleared the land, filled in gulches, leveled the property for irrigation and set out 740 acres to trees. Before the end of the first year the irrigating system was so far advanced that water was being delivered to the highest portion of the land. Before the end of the third year the remaining 260 acres of land were planted to orchard trees.

During the ten-year period covered by the lease the entire time of two of the stockholders, Messrs. Utt and Stevens, was devoted to the affairs of the corporation, for which they received no compensation except nominal salaries of $100.00 per month each in the nature of drawings accounts for living expenses.

Before the expiration of the lease the property had been highly improved, including the installation of a complete underground irrigation system, electric lights and electric power, modern houses and rooms, dining-room for employees, maintenance of a large automobile bus for the benefit of school children, postoffice for employees and the employment of a gardener to maintain the appearance of [91] the property immediately adjacent to the ranch headquarters.

On November 30, 1916, the San Joaquin Fruit Company's option to purchase the property was exercised and the first payment of $75,000.00 provided by the contract was made. The second and final payments of $50,000.00 and $75,000.00 were made on December 31, 1917, and October 28, 1918, respectively.

On November 30, 1916, the value of the real estate and trees thus acquired by the corporation was $1,854,000.00 as determined by independent appraisal.

In its return for the year 1921 the San Joaquin Fruit Company claimed as a part of its invested capital a paid-in surplus of $1,659,372.85 which represents the difference between the sum of $200,000.00 paid in cash as a portion of the purchase price of the property on November 30, 1916, and the value placed by the corporation on the real estate and trees on that date, which sum has been disallowed.

Upon the exercise of said option, and ever since San Joaquin Fruit Company has had, and is entitled to include in its invested capital, earned surplus and

undivided profits amounting to not less than $1,659,372.85 arising from the conversion of capital assets.

(d) In its return for the year 1921 the San Joaquin Fruit Company deducted depreciation of $59,710.96 covering depreciation of its physical properties including trees. This deduction was re- [92] duced to $58,135.69 by the Revenue Agent, but the Commissioner eliminated the major portion of the depreciation deduction applicable to the San Joaquin Fruit Company's orchard trees and did not give effect to the value of these assets at date of acquisition in establishing the deduction for depreciation. Said value as determined by independent appraisal was $1,100 per acre and the life of the trees was approximately 25 years from November 30, 1916.

(e) The value of the orchard trees leased to the San Joaquin Fruit Company on March 1, 1913, and to which title was acquired by it on November 30, 1916, was $1,115.00 per acre. However, the Income Tax Unit refused to consider the value at March 1, 1913, in establishing tree depreciation for the reason that title to the property was not acquired by the San Joaquin Fruit Company until November 30, 1916. As indicated hereinabove, the San Joaquin Fruit Company owned a property right on March 1, 1913, which was exchanged for a greater property right on November 30, 1916; but the Commissioner has not given effect either to the value of property rights at March 1, 1913, or November 30, 1916, in establishing the depreciation deduction.

(f) The San Joaquin Fruit Company's application for assessment under the provisions of Sections 327 and 328 of the Revenue Act of 1921 was favorably entertained by the Commissioner, who determined that abnormalities of invested capital were present for the year 1921 entitling the San [93] Joaquin Fruit Company to assessment under these sections. A careful and diligent inquiry discloses the fact that the representative companies whose circumstances were similar to the San Joaquin Fruit Company during the year in question failed to pay the rate of excess profits tax stated by the Commissioner to constitute the fair comparative rate.

All facts stated hereinabove which relate to the San Joaquin Fruit Company are, for the purposes of this petition, stated to be upon information and belief, because the San Joaquin Fruit Company a dissolved corporation, was the real taxpayer and not the petitioner.

WHEREFORE, the petitioner prays that this Board may hear the proceeding and hold as follows:

(a) That no deficiency in tax on the part of the San Joaquin Fruit and Investment Company as a taxpayer exists for the year in question.

(b) That no deficiency in tax, nor any liability, on the part of the San Joaquin Fruit and Investment Company as a transferee exists for the year in question.

(c) That the Commissioner of Internal Revenue is without jurisdiction as hereinabove alleged.

(d) That assessment of the taxes in controversy against San Joaquin Fruit Company, a corporation,

is barred by limitation of time, under Section 277 of the Revenue Act of 1926.

(e) That assessment of any alleged liability against petitioner as a transferee of property of [94] said taxpayer is barred by limitation of time under Section 280 of the Revenue Act of 1926.

(f) That no tax liability is due from the San Joaquin Fruit Company for the following reasons:

(1) That the San Joaquin Fruit Company is entitled to paid-in surplus in the sum of $1,659,372.85 for the calendar year 1921.

(2) That the San Joaquin Fruit Company is entitled to depreciation for the year 1921 based on the November 30, 1916, value of its orchard trees.

(3) That the San Joaquin Fruit Company is entitled to depreciation for the year 1921 based on the March 1, 1913, value of its leasehold and option.

(4) That the San Joaquin Fruit Company is entitled to additional relief for the year 1921 under the provisions of Sections 327 and 328 of the Revenue Act of 1921.

(g) That judgment of this Board be entered herein in favor of petitioner.

(Signed) N. L. McLAREN, C. P. A.
N. L. McLAREN, C. P. A.
444 California Street,
San Francisco, Calif.,
(Signed) GEORGE M. NAUS.
GEORGE M. NAUS, Attorney,
582 Market Street,
San Francisco, Calif.
(Signed) DANA LATHAM.
DANA LATHAM, Attorney.
New Title Insurance Bldg.,
Los Angeles, Calif.,
Counsel for Petitioner. [95]

City of Washington,
District of Columbia.—ss.

C. E. UTT, being first duly sworn, deposes and says that he is President of the San Joaquin Fruit & Investment Co., the petitioner above named; that he has read the foregoing petition and the facts set forth are true and correct to the best of his knowledge and belief.

.....

Subscribed and sworn to before me this.....day of October, 1928.

.....,
Notary Public.

My commission expires.....

City of Washington,
District of Columbia.—ss.

Dana Latham, being first duly sworn, deposes and says that he is one of the attorneys of record of the San Joaquin Fruit & Investment Company, the petitioner in this case, and has authority to verify the foregoing petition; that he has read the said petition and the facts contained therein he believes to be true upon information furnished him by the taxpayer, which information he believes to be correct.

DANA LATHAM.

Subscribed and sworn to before me this 10th day of October, 1928.

(Sgd.) AMY FAIRLESS,
Notary Public.

My commission expires Sept. 9, 1933. [96]

EXHIBIT "A."

Form NP—2

TREASURY DEPARTMENT,
Washington, D. C.
Office of
Commissioner of Internal
Revenue

September 1, 1926.

IT:E:SM-60D.
HMW-D-29804.
San Joaquin Fruit Company,
c/o San Joaquin Fruit and Investment
Company,
Tustin, California.

Sirs:

An audit of your income and profits tax return for the calendar year 1921 has resulted in the determination of a deficiency in tax of $21,867.40 as shown in Bureau letter dated July 20, 1926.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day. [97]

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days

prescribed and an assessment has been made or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:E:SM-60D-HMW-D-29804. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,

By .....,

Assistant to the Commissioner.

Inclosures:

Form A.

" 882. tel-1. [98]

EXHIBIT "B."

Form NP-1.

TREASURY DEPARTMENT,
Washington, D. C.
Office of
Commissioner of Internal Revenue.

July 20, 1926.

IT-E-SM.
HMW-D-29804.
San Joaquin Fruit Company,
c/o San Joaquin Fruit and Investment Company,
Tustin, California.

Sirs:

An audit of your income and profits tax return for the year ended December 31, 1921 has resulted in the determination of a deficiency in tax of $21,867.40, as shown the attached statement.

You are granted 30 days from the date of this letter within which to present a protest against the deficiency proposed herein. The protest and any additional statement of facts must be executed in triplicate, under oath, and contain the following information:

(a) The name and address of the taxpayer (in the case of an individual the residence, and in the case of a corporation the principal office or place of business); (b) in the case of a corporation the name of the State of incorporation; (c) the designation by date and symbol of the letter advising of the proposed deficiency with respect to which the

[99] protest is made; (d) the designation of the year or years involved and a statement of the amount of tax in dispute for each year; (e) an itemized schedule of the findings to which the taxpayer takes exception; (f) a summary statement of the grounds upon which the taxpayer relies in connection with each exception; and (g) in case the taxpayer desires a hearing, a statement to that effect.

If a protest is filed, any additional evidence or briefs of argument submitted will be given careful consideration, and if the Commissioner finally determines that there is a deficiency, you will be advised thereof by registered mail in accordance with the provisions of Section 274 of the Revenue Act of 1926. Should you not agree to the deficiency as finally determined by the Commissioner, you will be allowed 60 days from the date of mailing of the registered letter (not counting Sunday as the sixtieth day) in which to file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

If you acquiesce in the proposed deficiency as shown in this letter and the accompanying statement, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the inclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:E:SM-HMW-D-29804. In the event that you acquiesce in a part of such deficiency, the waiver should be [100]

executed with respect to the items to which you agree.

Respectfully,
C. R. NASH,
Assistant to the Commissioner.
By .....

Inclosures.
Statement.
Form A.
Form 883.
asc-1.

STATEMENT.

IT:E:SM.
HME-D-29804.
In re: SAN JOAQUIN FRUIT AND INVESTMENT COMPANY.
Tustin, California.

Year.	Deficiency in Tax
1921.	$21,867.40

You are advised that after careful consideration and review, your application under the provisions of Section 327 for assessment of your profits tax as prescribed by Section 328 of Revenue Act of 1921 has been allowed. Your profits tax is based upon a comparison with the group of representative concerns which in the aggregate may be said to be engaged in a like or similar trade or business to that of your company.

The result of the audit under the above mentioned provisions is as follows: [101]

1921.

Profits Tax, Section 328			$19,609.60
Net income as reported by revenue agent		$120,002.33	
Less:			
Interest on U. S. Obligations not exempt	$ 1,085.93		
Profit Tax	19,609.60	20,695.53	
Balance		$99,306.80	
Tax at 10%			9,930.68
Total tax assessable			$29,540.28
Original tax #401704			7,672.88
Deficiency in Tax			$21,867.40

[102].

A copy of this communication has been forwarded to your authorized representative, McLaren, Goode and Company, San Francisco, California. [103]

United States Board of Tax Appeals

Docket No. 27038

SAN JOAQUIN FRUIT & INVESTMENT COMPANY, Successor to San Joaquin Fruit Company through change of name only,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above named taxpayer hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter dated February 28, 1927, bearing symbols IT:CA:2554-6-60D, and as the basis of its appeal sets forth the following:

1. Taxpayer is a corporation with principal place of business at Tustin, California.

2. The deficiency letter, a copy of which is attached, is dated February 28, 1927, and was presumably mailed on said date.

3. The tax in controversy is income tax for the calendar year 1922 and is in excess of $10,000.00, to-wit: $58,422.79.

4. The determination of tax contained in said deficiency letter is based on the following errors, to-wit:

(a) In determining the taxable net income of the corporation for the taxable year in question, said taxable income was overstated in that an excessive profit was found in connection with the sales of real estate made by the corporation during said year, due to the fact that the Commissioner failed to allow the March 1, 1913 value of the corporation's interest in said real estate as the basis for the computation of said taxable profit.

(b) The taxable net income of the corporation for said year 1922 was further overstated, due to the fact that the Commissioner failed to compute depreciation on the March 1, 1913 value of citrus and walnut trees owned by the corporation.

5. The facts relied on as the basis of this appeal are as follows: [104]

(a) On October 5, 1906, this corporation leased from the Irvine Company One Thousand (1,000) acres of land, agreeing to pay as rental therefor, one-fourth (1/4th) of the gross proceeds received annually from said property. Said agreement further contained an option to purchase the land referred to in ten (10) years for a stipulated sum of $200,000.00. The land was at once set out to walnut and citrus trees, and at the same time a complete underground irrigation system was installed, together with electric lights, electric power, sewer system and so forth.

(b) On October 1, 1916, the corporation exercised its option to buy the land and during the period from November 17, 1916 to October 29, 1918, it paid the sum of Two Hundred Thousand Dollars, ($200,000.00) therefor, in accordance with the terms of the option agreement.

(c) During the year 1922 the corporation sold 368.495 acres of the property and in computing the taxable profit shown on its income tax return it used as the basis for determining said profit, the March 1, 1913 value of the property sold.

(d) The Commissioner of Internal Revenue, instead of using the March 1, 1913 value for the purpose of arriving at the taxable profit realized through sale, used as the basis for determining such profit the $200,000.00 paid by the company in 1916 under the terms of the option agreement.

(e) In the preparation of its income tax return for the year 1922, the corporation claimed a deduction on account of depreciation sustained on citrus and walnut trees, based on the March 1, 1913 value of said trees. The Commissioner disallowed the amount of depreciation so deducted and substituted therefor a depreciation based on the alleged cost of the trees to the corporation in the year 1916 when it acquired the property through the exercise of the option agreement.

(f) While it is admitted that this corporation did not have legal title to the land and trees on March 1, 1913, and that it was operating the property under a lease from the Irvine Company,

nevertheless, it is alleged that at the time the lease was entered into it was the understanding of all the parties concerned that the option to purchase embodied in the lease would be exercised, and it was because of this fact that the corporation immediately began to develop the raw land by planting the same to citrus and walnut trees, and installing the irrigation system and other improvements above mentioned.

(g) By March 1, 1913, the trees planted had reached an approximate age of seven (7) years and were conservatively valued, exclusive of the land, at $1,115.00 per acre. When the corporation's returns for years prior to 1922 were examined, the Revenue Agent who made the [105] examination agreed that a value of $1,115.00 per acre for the trees alone was conservative, and it is alleged that by reason of the fact that the land and trees combined were worth approximately $1,865.00 per acre on March 1, 1913, it was clearly indicated that this company intended to exercise its option to buy the land in accordance with the terms of the option agreement, in order to secure the legal title to the property.

(h) It is further alleged that the terms and conditions under which said property was leased were entirely different from a lease of real property upon which annual crops are planted and grown, since in the latter case the value of the property is not being increased by reason of the growing of annual crops beyond the natural appreciation in value which may take place on account of the in-

crease in population, etc., while in the case of the 1,000 acres leased by this corporation from the Irvine Company, this corporation was required under the terms of the lease to plant the land to citrus and walnut trees, which fact caused the value of the real property to increase anywhere from five to ten times.

(i) By reason of the foregoing facts, it is alleged that it could very well be held that the terms and conditions under which our corporation acquired title to the property were the same as if a contract to purchase the property had been entered into when the lease was first executed, and it had been provided that annual payments were to be made in amounts similar to those which were required to be paid as rentals under the terms of the lease with final payment to be made at the termination of the ten year period, and this was in effect what was done. In the meantime, the land was being intensively developed and this corporation had all the rights and benefits of ownership, just the same as it would have had, had the legal title therein vested in the corporation.

(j) If it had not been the intention of the company to exercise the option provided for and thus to acquire the legal title to the property, the officers of the corporation would not have proceeded with the development of the property in such manner as to increase its value during the seven-year period from 1906 to 1913, from $200.00 per acre to a value of approximately $1800.00 per acre.

(k) Based on the price at which similar improved property was being sold on March 1, 1913, it is alleged that the corporation could have disposed of its interest in the property, consisting of option agreement to purchase for an amount equal to $1800.00 per acre on March 1, 1913.

(l) This company had a property right in the property on March 1, 1913 equivalent to $1800.00 per acre, which property right consisted of the option to purchase the property as described in the lease entered into with the Irvine Company and said property right would have been fully protected under the law. [106]

(m) In the year 1916 this corporation in effect exchanged its then valuable property right consisting of the option agreement covering the sale and purchase of the property, together with the $200,000.00 in cash, for the property itself and thereafter its property right was represented by the land and trees rather than by the option to purchase, and it is alleged that the company would be justified in claiming that the basis for determining taxable profits realized on the sale of the property would be the value of the property in 1916, rather than on March 1, 1913, for the reason that the property was acquired through an exchange in the manner set out above, which under the Revenue Act of 1916 would have been regarded as a closed transaction.

(n) In the preparation of its return for 1922, the corporation claimed an allowance for depreciation on account of citrus and walnut trees of $21,112.57, and it is alleged that the Commissioner was

in error in disallowing said deduction and that for depreciation purposes the March 1, 1913 value should be used as the basis. In support of its contentions the petitioner cites Solicitor's Opinion No. 1110, Bulletin 1-2-705, wherein it was held that an individual who had filed on a placer mining claim prior to 1913, but who had not received patent to the land from the Government on said date, and in fact did not have his interest in said property recognized by the Government until 1920, was nevertheless entitled to a deduction on account of depletion sustained, based on whatever value attached to the property on March 1, 1913.

(o) Reliance is also had on the decision rendered by the Board on the appeal of Arthur B. Groves, Docket No. 1159, Decision No. 1187, wherein agreement entered into between a partnership and the owners of certain property under the terms of which the partnership was to sell the property, bearing all the expense of subdivision, etc., and out of the gross receipts was to pay the owners of the property a fixed amount was construed as an agreement or contract covering the sale of the property by the owner to the partnership, so that the partnership was entitled to consider that it had an interest in the property as of March 1, 1913, and set up a value as of that date for the purpose of determining profit on the sale of said property.

WHEREFORE, This petitioner prays that this Board may hear its petition and find that the de-

ficiency in tax proposed by the Commissioner should not be asserted.

SAN JOAQUIN FRUIT AND INVESTMENT COMPANY (Formerly San Joaquin Fruit Company)

By C. V. Newman,
Secretary.

CLAUDE I. PARKER,
Atty.

Per Frank G. Butts,
910-912 Investment Bldg.,
Washington, D. C.

State of California,
County of Orange—ss.

C. V. Newman, of the City of Tustin, State and County aforesaid, being first duly sworn upon his oath deposes and says: [107]

That he is the Secretary of the San Joaquin Fruit and Investment Company, a corporation with principal place of business at Tustin, California. That said corporation succeeded the San Joaquin Fruit Company, through change of name only, during the year 1922, and is the petitioner referred to in the foregoing petition.

That he has read the said petition or has had the same read to him, and is familiar with the statements therein contained and that the facts stated therein are true and correct, except such facts as are stated to be on information and belief, and those facts he believes to be true.

C. V. NEWMAN.

Subscribed and sworn to before me this 15 day of April, 1927.

[Seal] MARGUERITE LESAGE,
Notary Public in and for the County of Orange, State of California. [108]

TREASURY DEPARTMENT
Washington

Feb. 28, 1927

Office of
Commissioner of Internal
Revenue
IT:CA:2554—6—60D
San Joaquin Fruit Company,
Tustin, California.

Sirs:

The determination of your income tax liability for the year 1922, pursuant to an examination of your books of account and records, as set forth in office letter dated January 24, 1927 disclosed a deficiency in tax amounting to $58,422.79, as shown in the attached statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be

mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:CA:2554-6-60D. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,
D. H. BLAIR,
Commissioner.
By (Signed) C. R. NASH,
Assistant to the Commissioner.

Enclosures:
Statement
Waiver—Form A.
Form 882. [109]

STATEMENT.

IT:CA:2554-6-60D

In re: San Joaquin Fruit Company,
Tustin, California.

Year	Deficiency in Tax
1922	$58,422.79

Net Income

Net income reported		$ 864,154.06
Add:		
1. Excessive depreciation on fruit trees		21,112.57
2. Additional profit on sale of land		452,346.76
Total		$1,337,613.39
Deduct:		
3. Depreciation allowed on irrigation system		6,076.80
Net income as adjusted		$1,331,536.59

Explanation of Adjustments to Net Income

1. Depreciation has been computed on fruit trees in accordance with Article 161 of Regulations 62, as follows:

Depreciation claimed		$21,786.92
Total cost of all fruit trees	$35,595.24	
Portion unsold 63.15% or	22,478.39	
Depreciation allowable at 3%		674.35
Excessive depreciation		$21,112.57

2. The profit on sale of land has been adjusted as follows:

Gross sales price	$1,119,244.50

[110]

Continued—Explanation of Adjustments

Amount brought forward		$1,119,244.50
Less:		
Commissions and title fees, omitted in error in computation in return		54,116.52
Net sale price		$1,065,127.98
Cost of property sold:		
Total cost of land and trees	$235,595.24	
Total cost of irrigation system	185,059.77	
Power Plant	6,068.53	
Buildings	1,327.84	
Total costs	$428,051.38	
Less:		
Depreciation previously allowed:		
On fruit trees	$9,664.65	
On irrigation system	38,212.19	47,876.84
Depreciated cost for acreage owned	$380,174.54	
As 368.495 acres of the 1000 acres owned were sold, the cost of the property sold is 36.8495% or		140,092.42
Corrected profit		$ 925,035.56
Profit shown in return		472,688.80
Additional profit		$ 452,346.76

3. Depreciation on irrigation system has been computed in accordance with Article 161 of Regulations 62, as follows:

Asset value, January 1, 1922	$ 185,059.77

[111]

Continued—Explanation of Adjustments

Amount brought forward	$185,059.77
Adjustment for power plant and buildings	7,396.37
Total	$192,456.14
Portion sold 36.85% or	70,920.09
Depreciable balance	$121,536.05
Depreciation allowable at 5%	$ 6,076.80

Computation of Tax

Net income	$1,331,536.59
Balance subject to tax at 12½%	$1,331,536.59
Total tax assessable	$166,442.07
Original Tax	108,019.28
Deficiency in tax	$ 58,422.79

Payment of the tax should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

[Endorsed]: United States Board of Tax Appeals. Filed Apr. 21, 1927. [112]

[Title of Court and Cause—Docket No. 27038.]

ANSWER.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraph 1 of the petition.

(2) Admits the allegations contained in paragraph 2 of the petition.

(3) Admits the allegations contained in paragraph 3 of the petition.

(4) Denies the respondent erred in the determination of the tax liability of the petitioner for the year 1922.

(5)(a) Admits the allegations contained in paragraph 5(a) of the petition.

(b) Admits the allegations contained in paragraph 5(b) of the petition.

(c) Admits the allegations contained in paragraph 5(c) of the petition.

(d) Admits the allegations contained in paragraph 5(d) of the petition, but denies the respondent erred thereby.

(e) Admits the allegations contained in paragraph 5(e) of the petition.

(f) For lack of information upon which to form a belief, denies the allegations contained in paragraph (5f) of the petition.

(g) For lack of information upon which to form

a belief, denies the allegations contained in paragraph 5(g) of the petition.

(h) Denies the allegations contained in paragraphs 5(k) and 5(l) of the petition. [113]

(i) Admits a deduction for depreciation on account of citrus and walnut trees of $21,112.57 was claimed by the petitioner.

(6) Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the appeal be denied.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
GRANVILLE S. BORDEN,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: United States Board of Tax Appeals. Filed May 25, 1927. [114]

[Title of Court and Cause—Docket No. 27038.]

AMENDED AND SUPPLEMENTAL PETITION.

The above-named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter (IT:CA: 2554-6-60D) bearing on its face the date February 28, 1927, and as a basis of its appeal sets forth the following:

1. The petitioner is a California corporation organized on or about July 24, 1922, but which transacted no business and had no income prior to December 26, 1922.

2. The deficiency letter, a copy of which is attached to petitioner's original petition and marked Exhibit "A", purports on its face to have been mailed to the San Joaquin Fruit Company on February 28, 1927.

3. The taxes in controversy are not the taxes of this petitioner, but appear to be income taxes for the calendar year 1922, assessable, if at all, against San Joaquin Fruit Company, a corporation other than this petitioner, and are more than $10,000.00, to-wit: $58,422.79.

4. The determination of tax contained in said deficiency letter is based upon the following errors:

(a) This petitioner, not having transacted any business or received any income prior to December 26, 1922, could not be liable [115] as a taxpayer for any alleged deficiency asserted under the provisions of Section 274(d) of the Revenue Act of 1926 against San Joaquin Fruit Company for the year 1922.

(b) This petitioner, being a taxpayer other than the taxpayer to whom the sixty day letter herein appealed from was addressed, cannot be made to respond for any tax alleged to be due from San Joaquin Fruit Company for the year 1922, or any other year.

(c) Upon information and belief, petitioner alleges that the determination of tax liability for

the year 1922, as set forth in the respondent's sixty-day letter addressed to San Joaquin Fruit Company, is in error for the following reasons:

(1) Respondent found a taxable profit based on the alleged cost to petitioner in 1916 of certain property sold, whereas said profit should be determined based either on the value of the property as of March 1, 1913, or on its value as of the year 1916, when the option to purchase the property was exercised, either of which values was greatly in excess of the basis used by respondent.

(2) Respondent computed depreciation on citrus and walnut trees owned by said San Joaquin Fruit Company based on their alleged cost to said company in the year 1916, whereas said depreciation should be computed either on the March 1, 1913 value of said trees, or upon their value in the year 1916, when the option to purchase the property was exercised, either of which values was greatly in excess of the amount used by respondent.

5. The facts relied upon as the basis of this appeal are as follows:

(a) The San Joaquin Fruit Company, a corporation, was organized under the laws of the State of California on or about October 5, 1906, and was dissolved as provided by the laws of the State of California on or about December 26, 1922, and after December 26, 1922, [116] ceased to have any corporate existence for any purpose whatsoever.

(b) On or about July 24, 1922, this petitioner, San Joaquin Fruit and Investment Company, was

organized under the laws of the State of California, and commenced business on or about December 26, 1922. Prior to that date this petitioner transacted no business and received no income.

(c) In the original petition filed in this appeal it was stated that this petitioner, San Joaquin Fruit and Investment Company, is a successor to San Joaquin Fruit Company through change of name only. This statement was erroneous. This petitioner is not a successor to San Joaquin Fruit Company through change of name only, but is a distinct and separate corporation organized during the year 1922, under the laws of the State of California. From July 24, 1922 to on or about December 26, 1922, both of the said corporations were in existence.

(d) The sixty-day deficiency letter herein appealed from was addressed to San Joaquin Fruit Company, and San Joaquin Fruit and Investment Company, a corporation other than the addressee of said letter, without authority from said addressee, appealed from said letter.

(e) Upon information and belief this petitioner alleges the following facts with regard to the San Joaquin Fruit Company:

(1) On October 5, 1906, San Joaquin Fruit Company leased from the Irvine Company one thousand (1,000) acres of land, agreeing to pay as rental therefor, one-fourth (¼th) of the gross proceeds received annually from said property. Said agreement further contained an option to purchase the land referred to in ten (10) years for a stipulated

sum of $200,000.00. The land was at once set out to walnut and citrus trees, and at the same time a complete underground irrigation system was installed, together with electric lights, elec- [117] tric power, sewer system and so forth.

(2) On October 1, 1916, the corporation exercised its option to buy the land and during the period from November 17, 1916 to October 29, 1918, it paid the sum of Two Hundred Thousand Dollars ($200,000.00) therefor, in accordance with the terms of the option agreement.

(3) During the year 1922 the corporation sold 368.495 acres of the property and in computing the taxable profit shown on its income tax return, it used as the basis for determining said profit the March 1, 1913 value of the property sold.

(4) The respondent instead of using the March 1, 1913 value, or the value in 1916 when the option to purchase the property was exercised, for the purpose of arriving at the taxable profit realized through sale, used as the basis for determining such profit the $200,000.00 paid by the company in 1916, under the terms of the option agreement.

(5) In the preparation of its income tax return for the year 1922, the corporation claimed a deduction on account of depreciation sustained on citrus and walnut trees, based on the March 1, 1913 value of said trees. The respondent disallowed the amount of depreciation so deducted and substituted therefor a depreciation based on the alleged cost of the trees to the corporation in the year 1916, when it acquired the property through the exercise of the option agreement.

(6) While it is admitted that San Joaquin Fruit Company did not have legal title to the land and trees on March 1, 1913, and that it was operating the property under a lease from the Irvine Company, nevertheless, it is alleged that at the time the lease was entered into it was the understanding of all the parties concerned that [118] the option to purchase embodied in the lease would be exercised, and it was because of this fact that the corporation immediately began to develop the raw land by planting the same to citrus and walnut trees, and installing the irrigation system and other improvements above mentioned.

(7) By March 1, 1913, the trees planted had reached an approximate age of seven (7) years and were conservatively valued, exclusive of the land, at $1,115.00 per acre. When the corporation's returns for years prior to 1922 were examined, the Revenue Agent who made the examination agreed that a value of $1,115.00 per acre for the trees alone was conservative, and it is alleged that by reason of the fact that the land and trees combined were worth approximately $1,200.00 per acre on March 1, 1913, it was clearly indicated that this company intended to exercise its option to buy the land in accordance with the terms of the option agreement, in order to secure the legal title to the property.

(8) It is further alleged that the terms and conditions under which said property was leased were entirely different from a lease of real property upon which annual crops are planted and grown,

since in the latter case the value of the property is not being increased by reason of the growing of annual crops beyond the natural appreciation in value which may take place on account of the increase in population, etc., while in the case of the 1,000 acres leased by San Joaquin Fruit Company from the Irvine Company, San Joaquin Fruit Company was required under the terms of the lease to plant the land to citrus and walnut trees, which fact caused the value of the real property to increase anywhere from five to ten times.

(9) By reason of the foregoing facts, it is alleged that it could very well be held that the terms and conditions under which the corporation acquired title to the property were the same as [119] if a contract to purchase the property had been entered into when the lease was first executed, and it had been provided that annual payments were to be made in amounts similar to those which were required to be paid as rentals under the terms of the lease with final payment to be made at the termination of the ten-year period, and this was in effect what was done. In the meantime, the land was being intensively developed and this corporation had all the rights and benefits of ownership, just the same as it would have had, had the legal title therein vested in the corporation.

(10) If it had not been the intention of the company to exercise the option provided for, and thus to acquire the legal title to the property, the officers of the corporation would not have proceeded with the development of the property in such man-

ner as to increase its value during the seven-year period from 1906 to 1913, from $200.00 per acre to a value of approximately $1200.00 per acre.

(11) Based on the price at which similar improved property was being sold on March 1, 1913, it is alleged that the corporation could have disposed of its interest in the property, consisting of option agreement to purchase for an amount equal to $1200.00 per acre on March 1, 1913.

(12) The San Joaquin Fruit Company had a property right in the property on March 1, 1913, equivalent to $1200.00 per acre, which property right consisted of the option to purchase the property as described in the lease entered into with the Irvine Company and said property right would have been fully protected under the law.

(13) In the year 1916 the San Joaquin Fruit Company in effect exchanged its then valuable property right consisting of the option agreement covering the sale and purchase of the property, together with the $200,000.00 in cash, for the property itself and thereafter its property right was represented by the land and trees rather than by [120] the option to purchase, and it is alleged that the company would be justified in claiming that the basis for determining taxable profits realized on the sale of the property would be the value of the property in 1916, rather than on March 1, 1913, for the reason that the property was acquired through an exchange in the manner set out above, which, under the Revenue Act of 1916, would have been regarded as a closed transaction.

(14) In the preparation of its return for 1922, San Joaquin Fruit Company claimed an allowance for depreciation on account of citrus and walnut trees of $21,112.57, and it is alleged that the respondent was in error in disallowing said deduction and that for depreciation purposes either the March 1, 1913 value, or the value of the trees when they were acquired under the option agreement, should be used as the basis for computing depreciation. In support of this contention reference is made to Solicitor's Opinion No. 1110, Bulletin 1-2-705, wherein it was held that an individual who had filed on a placer mining claim prior to 1913, but who had not received patent to the land from the Government on said date, and in fact did not have his interest in said property recognized by the Government until 1920, was, nevertheless, entitled to a deduction on account of depletion sustained, based on whatever value attached to the property on March 1, 1913.

(15) Reliance is also had on the decision rendered by the Board on the appeal of Arthur B. Groves, Docket #1159, Decision #1187, wherein agreement entered into between a partnership and the owners of certain property under the terms of which the partnership was to sell the property, bearing all the expense of subdivision, etc., and out of the gross receipts was to pay the owners of the property a fixed amount, was construed as an agreement or contract covering the sale of the property by the owner to the partnership, so [121] that the partnership was entitled to consider that it had an

interest in the propery as of March 1, 1913, and set up a value as of that date for the purpose of determining profit on the sale of said property.

WHEREFORE, this petitioner prays that this Board may hear and determine this appeal and find that:

(a) The deficiency letter herein appealed from was addressed to San Joaquin Fruit Company, a taxpayer different and distinct from San Joaquin Fruit and Investment Company.

(b) That the additional tax, if any, due for the year 1922, from San Joaquin Fruit Company, should be redetermined in accordance with the allegations herein made.

(c) That no additional tax is due for the calendar year 1922, from San Joaquin Fruit and Investment Company.

CLAUDE I. PARKER
RALPH W. SMITH,
650 South Spring Street
Los Angeles, California.

DANA LATHAM
819 Title Insurance Bldg.
Los Angeles, California.

W. L. McLAREN
444 California Street
San Francisco, California
Counsel for Petitioner.

State of California,
County of Los Angeles.—ss.

C. E. Utt, being first duly sworn, on oath deposes and says that he is president of San Joaquin Fruit

and Investment Company, petitioner named in the foregoing petition, and is authorized to verify this [122] petition; that he has read the said petition and the facts stated therein are true and correct, except such facts as are stated to be on information and belief, and as to those facts he believes them to be true.

C. E. UTT

Subscribed and sworn to before me this 24th day of April, 1929.

MARGUERITE LESAGE
Notary Public in and for the County of Los Angeles, State of California.

[Endorsed]: United States Board of Tax Appeals. Filed May 6, 1929. [123]

[Title of Court and Cause—Docket No. 27038.]

OBJECTIONS TO THE BOARD'S ACTION IN PERMITTING THE FILING OF AN AMENDED AND SUPPLEMENTAL PETITION IN THIS APPEAL, AND, WITHOUT WAIVING SUCH OBJECTIONS, ANSWER TO AMENDED AND SUPPLEMENTAL PETITION.

Now comes the Commissioner of Internal Revenue, respondent herein, by C. M. Charest, General Counsel, Bureau of Internal Revenue, his attorney, and says that the San Joaquin Fruit & Investment Co. should not have been permitted to file the

amended and supplemental petition in this case, which permission was granted ex parte by the Board on May 6, 1929, and as reason for his objections the respondent says that the San Joaquin Fruit Co. filed its income tax return with the Collector of Internal Revenue of the Sixth District of California on June 15, 1923, that on February 28, 1927 a deficiency letter was sent by registered mail to said San Joaquin Fruit Co. at Tustin, California; that on April 21, 1927 there was filed with the Board by San Joaquin Fruit & Investment Co. a petition of appeal from said letter of February 28, 1927, wherein said San Joaquin Fruit & Investment Co. described itself as "successor to San Joaquin Fruit Company through change of name only" and as "formerly San Joaquin Fruit Company"; that the respondent believed that the San Joaquin Fruit & Investment Company was the same corporation as the San Joaquin Fruit Company and that relying on the representations [124] of said San Joaquin Fruit & Investment Company as aforesaid he forebore to assess the deficiency shown in the said deficiency letter of February 28, 1927 and he also forbore to proceed under Sec. 280 of the Revenue Act of 1926 against San Joaquin Fruit & Investment Company as transferee of the assets of San Joaquin Fruit Co.; that a period of more than four years has now elapsed and on May 3, 1929 had elapsed since the filing of the return of said San Joaquin Fruit Company for the calendar year 1922, and that a period of more than five years has elapsed and on May 3, 1929 had elapsed since the filing of

said return by said San Joaquin Fruit Company; and that it is now too late and on May 3 and May 6, 1929 it was too late to assess any deficiency in tax for the year 1922 against said San Joaquin Fruit Company and/or to proceed under sec. 280 of the Revenue Act of 1926 against said San Joaquin Fruit & Investment Company;

Wherefore the respondent says that the said San Joaquin Fruit & Investment Company and the said San Joaquin Fruit Company are estopped and should not be permitted to allege that said San Joaquin Fruit Company and said San Joaquin Fruit & Investment Company are not one and the same unchanged corporation.

Without waiving his objections as aforesaid but expressly reasserting and relying thereon, the respondent for answer to the amended and supplemental petition, admits and denies as follows: [125]

1. Admits that the petitioner is a California corporation. For lack of information upon which to base a belief, denied the remaining allegations in paragraph 1.

2. Admits the allegations in paragraph 2.

3. Admits that the taxes in controversy are income taxes for the calendar year 1922, of the San Joaquin Fruit Company, and are more than $10,000.00, to-wit, $58,422.79. Denies the remaining allegations in paragraph 3.

5(a). Admits that the San Joaquin Fruit Company, a corporation, was organized under the laws of the State of California on or about October 5, 1906. Denies the remaining allegations in paragraph 5(a).

5(b). Denies the allegations in paragraph 5(b).

5(c). Admits that in the original petition filed in this appeal it was stated that this petitioner, the San Joaquin Fruit & Investment Company, is successor to San Joaquin Fruit Company, through change of name only. Denies the remaining allegations in paragraph 5(c).

5(d). Admits that the 60-day deficiency letter herein appealed from was addressed to the San Joaquin Fruit Company. Denies the remaining allegations in paragraph 5(d).

5(e)—1 and 2. For lack of information upon which to base a belief, denies the allegations in paragraphs 5(e)—1 and 2.

5(e)—3. Admits that during the year 1922, the corporation, the San Joaquin Fruit Company, sold not less than 368.495 acres of property. Denies the remaining allegations in paragraph 5(e)—3. [126]

5(e)—4. Admits that the respondent in arriving at taxable profit realized through said sale used as the basis for determining such profit the alleged cost to said company. Denies the remaining allegations in paragraph 5(e)—4.

5(e)—5. Admits that in the preparation of its income tax return for the year 1922, the said corporation claimed a deduction on account of depreciation sustained on citrus and walnut trees based on an alleged March 1, 1913 value of said trees. Admits that the respondent disallowed the amount of depreciation so deducted and substituted therefor a depreciation based on the alleged cost of said trees to the corporation. Denies the remaining allegations in paragraph 5(e)—5.

5(e)—6. For lack of information upon which to base a belief, denies the allegations in paragraph 5(e)—6.

5(e), 7, 8, 9, 10, 11, 12, 13. Denies the allegations in paragraph 5(e), 7, 8, 9, 10, 11, 12, 13.

5(e)—14. Admits that a deduction of $21,112.57, alleged depreciation on citrus and walnut trees was claimed by the petitioner in its return for the year 1922. Denies the remaining allegations in paragraph 5(e)—14.

5(e)—15. Denies the allegations in paragraph 5(e)—15.

Denies generally and specifically each and every allegation in taxpayer's amended and supplemental petition not hereinbefore expressly admitted, qualified or denied.

WHEREFORE, it is prayed that the petition be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
JOHN D. FOLEY,
Special Attorney,
Bureau of Internal Revenue. 7/3/29.

[Endorsed]: United States Board of Tax Appeals. Filed Jul. 5, 1929. [127]

United States Board of Tax Appeals
Docket #40407

SAN JOAQUIN FRUIT & INVESTMENT CO.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION.

The above named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter dated June 27, 1928, bearing the symbols IT:AR:A-1 JCC-60D, and as the basis for its appeal sets forth the following:

(1) The petitioner is a corporation with principal place of business at Tustin, California.

(2) The deficiency letter, copy of which is attached, is dated June 27, 1928, and was presumably mailed on said date.

(3) The tax in controversy is income tax for the calendar years 1924 and 1925 and as determined by the Commissioner, is $13,864.23, apportioned—$2,898.43 for the year 1924 and $10,965.80 for the year 1925. The petitioner admits a deficiency of $334.83 for the year 1924 and $646.18 for the year 1925, or a total deficiency of $981.03, thereby leaving $12,883.22 in controversy.

(4) The determination of tax contained in said deficiency letter is based on the following errors, to-wit:

(a) In determining the taxable net income of the petitioner, for the year 1924, said income was overstated to the extent of [128] $20,408.82, due to the fact that the Commissioner failed to compute depreciation on the March 1, 1913 value of citrus and walnut trees owned by the corporation.

(b) In determining the taxable net income of the petitioner for the year 1925, said income was overstated to the extent of $79,381.73 in that—

(1) An excess profit of $58,972.91 was found in connection with the sales of real estate made by the petitioner during said year due to the fact that the Commissioner failed to allow the March 1, 1913 value of the petitioner's interest in said real estate as the basis for the computation of said taxable profit and—

(2) Deduction for depreciation was understated to the extent of $20,408.82 due to the fact that the Commissioner failed to compute depreciation on the March 1, 1913 value of citrus and walnut trees owned by the petitioner.

(5) The facts relied on as the basis of this appeal are as follows:

(a) On October 5, 1906, this petitioner leased from the Irvine Company, One Thousand (1,000) acres of land, agreeing to pay as rental therefor, one-fourth (¼th) of the gross proceeds received annually from said property. Said agreement further contained an option to purchase the land referred to in ten (10) years for a stipulated sum of $200,000.00. The land was at once set out to walnut and citrus trees, and at the same time, a com-

plete underground irrigation system was installed, together with electric lights, electric power, sewer system and so forth. [129]

(b) On October 1, 1916, petitioner exercised its option to buy the land and during the period from November 17, 1916, to October 29, 1918, it paid the sum of Two Hundred Thousand Dollars ($200,000.00) therefor, in accordance with the terms of the option agreement.

(c) In the preparation of its income tax return for the year 1924, petitioner claimed a deduction of $25,246.00 on account of depreciation sustained on citrus and walnut trees based on the March 1, 1913 value of said trees. The Commissioner disallowed the amount of depreciation so deducted and substituted therefor, an amount of $673.02 based on the alleged cost of the trees to the petitioner in the year 1916 when it acquired the property through the exercise of the option agreement. The petitioner now alleges that it is entitled to the depreciation on account of citrus and walnut trees for the year 1924 in the amount of $21,081.84 and that the Commissioner understated the allowable depreciation to which the petitioner is entitled on citrus and walnut trees to the extent of $20,408.82.

(d) During the year 1925, the petitioner sold 46.3012 acres of its citrus land and trees and in computing the taxable profit shown on its income tax return of $11,831.33, it used as the basis for determining said profit, the March 1, 1913 value of the property sold with subsequent adjustments for depreciation etc. It now admits that a taxable

profit was realized of $12,482.03. The Commissioner fixed a profit on the sale of—$71,454.94 by using as the basis for determining such profit, the $200,000.00 paid by the company in 1916 under the terms of the option agreement instead of using the March 1, 1913 value of the property sold. [130]

(e) In the preparation of its income tax return for the year 1925, the petitioner claimed a deduction of $24,620.78 on account of depreciation sustained on citrus and walnut trees based on the March 1, 1913 value of said trees. The Commissioner disallowed the amount of depreciation so deducted and substituted therefor, a depreciation of $673.02 on the alleged cost of the trees to the petitioner in the year 1916 when it acquired the property through the exercise of the option agreement. The petitioner now alleges it was entitled to a depreciation on the citrus and walnut trees of $21,081.84 or $20,408.82, in excess of the allowance made by the Commissioner.

(f) While it is admitted that this petitioner did not have legal title to the land and trees on March 1, 1913, and that it was operating the property under a lease from the Irvine Company, nevertheless, it is alleged that at the time the lease was entered into it was the understanding of all the parties concerned that the option to purchase embodied in the lease would be exercised, and it was because of this fact that the petitioner immediately began to develop the raw land by planting the same to citrus and walnut trees, and installing the irrigation system and other improvements above mentioned.

(g) By March 1, 1913, the trees planted had reached an approximate age of seven (7) years and were conservatively valued, exclusive of the land, at $1,115.00 per acre. When the petitioner's returns for years prior to 1922 were examined, the Revenue Agent who made the examination agreed that a value of $1,115.00 per acre for the trees alone was conservative, and it is alleged that by reason of the fact that the land and trees combined were worth [131] approximately $1,865.00 per acre on March 1, 1913, it was clearly indicated that the petitioner intended to exercise its option to buy the land in accordance with the terms of the option agreement, in order to secure the legal title to the property.

(h) It is further alleged that the terms and conditions under which said property was leased were entirely different from a lease of real property upon which annual crops are planted and grown, since in the latter case the value of the property is not being increased by reason of the growing of annual crops beyond the natural appreciation in value which may take place on account of the increase in population, etc., while in the case of the 1,000 acres leased by this corporation from the Irvine Company, this corporation was required under the terms of the lease to plant the land to citrus and walnut trees, which fact caused the value of the real property to increase anywhere from five to ten times.

(i) By reason of the foregoing facts, it is alleged that it could very well be held that the terms and

conditions under which the petitioner acquired title to the property were the same as if a contract to purchase the property had been entered into when the lease was first executed, and it had been provided that annual payments were to be made in amounts similar to those which were required to be paid as rentals under the terms of the lease with final payment to be made at the termination of the ten year period, and this was in effect what was done. In the meantime, the land was being intensively developed and this petitioner had all the rights and benefits of ownership, just the same as it would have had, had the legal title therein vested in the petitioner. [132]

(j) If it had not been the intention of the company to exercise the option provided for and thus to acquire the legal title to the property, its officers would not have proceeded with the development of the property in such manner as to increase its value during the seven-year period from 1906 to 1913, from $200.00 per acre to a value of approximately $1,800.00 per acre.

(k) Based on the price at which similar improved property was being sold on March 1, 1913, it is alleged that the petitioner could have disposed of its interest in the property, consisting of option agreement to purchase for an amount equal to $1,800.00 per acre on March 1, 1913.

(l) This petitioner had a property right in the property on March 1, 1913 equivalent to $1,800.00 per acre, which property right consisted of the op-

tion to purchase the property as described in the lease entered into with the Irvine Company and said property right would have been fully protected under the law.

(n) In the year 1916 this petitioner in effect exchanged its then valuable property right consisting of the option agreement covering the sale and purchase of the property, together with the $200,000.00 in cash, for the property itself and thereafter its property right was represented by the land and trees rather than by the option to purchase, and it is alleged that it is justified in claiming that the basis for determining taxable profits realized on the sale of the property would be the value of the property in 1916, rather than on March 1, 1913, for the reason that the property was acquired through [133] an exchange in the manner set out above, which under the Revenue Act of 1916, would have been regarded as a closed transaction.

(n) In further support of its contention that it is entitled to use the March 1, 1913 value of the land and trees as the basis for determining taxable profit on the subsequent sale thereof and the allowable depreciation to be deducted from its gross income, the petitioner cites the Solicitor's Opinion #1110 Bulletin 1-2-705 wherein it was held that an individual who had filed on a placer mining claim prior to 1913, but who had not received patent to the land from the Government on said date and

in fact, did not have his interest in said property recognized by the Government until 1920 was, nevertheless, entitled to a deduction on account of depletion sustained based on whatever value attached to the property on March 1, 1913.

(o) Reliance is also had on the decision rendered by the Board on the appeal of Arthur B. Groves, Docket No. 1159, Decision No. 1187, wherein agreement entered into between a partnership and the owners of certain property under the terms of which the partnership was to sell the property, bearing all the expense of subdivision, etc., and out of the gross receipts was to pay the owners of the property a fixed amount, was construed as an agreement or contract covering the sale of the property by the owner to the partnership, so that the partnership was entitled to consider that it had an interest in the property as of March 1, 1913, and to set up a value as of that date for the purpose of determining profit on the sale of said property. [134]

WHEREFORE, this petitioner prays that this Board may hear its petition and find that the deficiency in tax proposed by the Commissioner should not be asserted.

SAN JOAQUIN FRUIT AND
INVESTMENT COMPANY,
By C. V. Newman,
Assistant Secretary.

CLAUDE I. PARKER, Atty.
Per FRANK G. BUTTS
910-912 Investment Bldg.
Washington, D. C.

State of California,
County of Orange.—ss.

C. V. Newman, of the City of Tustin, State and County aforesaid, being first duly sworn upon his oath deposes and says that he is the Assistant Secretary of the San Joaquin Fruit and Investment Company, a corporation with principal place of business at Tustin, California, and that said corporation is the petitioner referred to in the foregoing petition and that he has read the said petition or has had the same read to him and is familiar with the statements therein contained and that the facts therein stated are true and correct, except such facts as are stated to be on information and belief and those facts he believes to be true.

C. V. NEWMAN.

Subscribed and sworn to before me this 15th day of August, 1928.

[Seal] W. S. LEINBERGER
Notary Public in and for the County of Orange, State of California.

My Commission expires Aug. 16, 1928. [135]

TREASURY DEPARTMENT
Washington

Office of
Commissioner of Internal
Revenue

June 27, 1928

San Joaquin Fruit & Investment Company,
Tustin, California.

Sirs:

In accordance with Section 274 of the Revenue Act of 1926 you are advised that the determination of your tax liability for the years 1924 and 1925 discloses a deficiency of $13,864.23, as shown in the attached statement.

The section of the law above mentioned allows you an appeal to the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter. However, if you acquiesce in this determination, you are requested to execute the inclosed Form A and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,
D. H. BLAIR,
Commissioner.
By (Signed) C. B. ALLEN,
Deputy Commissioner.

Inclosures:
Statement.
Form A.
Form 882. [136]

STATEMENT

IT:AR:A-1
JCC-60D

In re: San Joaquin Fruit & Investment Company,
Tustin, California.

Year	Deficiency in Tax
1924	$2,898.43
1925	10,965.80
Total	$13,864.23

Reference is made to the report of the Internal Revenue Agent in Charge, San Francisco, California for the years 1924 and 1925, and to your protest submitted under date of April 2, 1928.

Careful consideration has been accorded your protest, in connection with the agent's findings and the adjustments recommended in the agent's report have been approved by this office.

Your contention that depreciation on trees should be computed on a March 1, 1913 value instead of cost, is denied.

Since the land upon which the trees are located was acquired subsequent to February 28, 1913, it is held by this office that the cost of trees is the correct basis for the computation of depreciation. Section 204 (c) of the Revenue Acts of 1924 and 1926.

Your contention that the March 1, 1913 value of land is the correct basis for the computation of profit on the sale of land is denied.

Since the land was not acquired by the taxpayer until after February 28, 1913, it is held by this office that the correct basis for the computation of profit on the sale of land is the cost at date of acquisition. Section 204 (a) of the Revenue Acts of 1924 and 1926.

1924

Net income reported	$67,432.99
Add: 1. Excessive depreciation on trees	24,572.98
Total	$92,005.97
Deduct: 2. Depreciation on sundry assets	1,385.57
Net income as adjusted	$90,620.40

[137]

Explanation of Changes

1. Depreciation sustained on trees has been computed under the provisions of Article 161, Regulations 65. The computation is shown below:

Asset	Cost	Rate	Depreciation
Trees	$22,433.90	3%	$ 673.02
Depreciated deducted			25,246.00
Excessive depreciation			$ 24,572.98

2. Depreciation on sundry assets has been adjusted under the provisions of Article 161, Regulations 65.

Depreciation allowed	$13,436.14
Depreciation claimed	12,050.57
Additional depreciation	$ 1,385.57

The computation in detail is shown in Exhibit "B" of the revenue agent's report, a copy of which has been furnished you.

Computation of Tax

Net income		$ 90,620.40
Income tax at 12½%		$ 11,327.55
Tax previously assessed		8,429.12
Deficiency in tax		$ 2,898.43

1925

Net income reported		$ 45,680.45
Add: 1. Excessive depreciation on trees	$23,947.76	
2. Depreciation on sundry assets	780.98	
3. Additional profit on sale of land	59,623.61	84,352.35
Net income as adjusted		$130,032.80

Explanation of Changes

1. Depreciation sustained on trees has been computed under the provisions of Article 161, Regulations 69. The computation is shown below:

Asset	Cost	Rate	Depreciation
Trees	$22,433.90	3%	$ 673.02
Depreciation claimed			24,620.78
Excessive depreciation			$ 23,947.76

[138]

2. Depreciation on sundry assets has been adjusted under the provisions of Article 161, Regulations 69.

Depreciation claimed	$17,166.12
Depreciation allowed	16,385.14
Excessive depreciation	$ 780.98

The computation in detail is shown in Exhibit B of the revenue agent's report, a copy of which has been furnished you.

3. The profit on the sale of land has been computed as provided in Section 204 (a) of the Revenue Act of 1926.

Sale price of 46.3012 acres	$90,390.74
Cost of land and improvements	18,935.80
Correct profit	$ 71,454.94
Profit reported	11,831.33
Additional profit	$ 59,623.61

Computation of Tax

Net income	$130,032.80
Income tax at 13%	$ 16,904.26
Tax previously assessed	5,938.46
Deficiency in tax	$ 10,965.80

Your claim for the refund of $486.66, part of income tax for 1924, has been examined.

An examination of your books and records for 1924 discloses tax liability in excess of the amount assessed. The claim will, therefore, be rejected and the rejection will appear on a schedule to be approved by the Commissioner.

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

[Endorsed]: United States Board of Tax Appeals. Filed Aug. 22, 1928. [139]

[Title of Court and Cause—Docket No. 40407.]

ANSWER.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer admits and denies as follows:

1, 2. Admits the allegations in paragraphs 1 and 2.

3. Admits that the taxes in controversy are income taxes for the calendar years 1924 and 1925. Denies the remaining allegations in paragraph 3.

5,(a),(b). For lack of information upon which to base a belief, denies the allegations in paragraphs 5,(a) and (b).

(c) Admits that the petitioner deducted from gross income as shown in its income tax return for

the year 1924 the sum of $25246.00, as depreciation on trees. Admits that the Commissioner in determining the deficiency shown in the 60-day letter dated June 27, 1928, disallowed the amount so deducted and substituted therefor the amount of $673.02, based upon the alleged cost of said trees in the year 1916. Denies the remaining allegations in paragraph 5(c).

(d) Admits that during the year 1925 the petitioner sold 46.3012 acres of land and improvements. Admits that the petitioner reported in its income tax return for the year 1925 the sum of $11,831.33 as profit from said sale based upon an alleged March 1, 1913 value. Admits that the Commissioner in determining the deficiency shown in the 60-day letter dated [140] June 27, 1928 computed a profit on said sale in the sum of $71,454.94 based upon the alleged cost in 1916. Denies the remaining allegations in paragraph 5(d).

(e) Admits that the petitioner deducted from the gross income as shown on its income tax return for the year 1925 the sum of $24,620.78 as depreciation on trees based upon an alleged March 1, 1913 value. Admits that the Commissioner in determining the deficiency shown in the 60-day letter dated June 27, 1928, disallowed the amount of depreciation so deducted and substituted therefor a depreciation of $673.02 based upon the alleged cost of the trees in the year 1916. Denies the remaining allegations in paragraph 5(e).

(f) For lack of information upon which to base a belief, denies the allegations in paragraph 5(f).

(g) Denies the allegations in paragraph 5(f).

(h) For lack of information upon which to base a belief, denies the allegations in paragraph 5(h).

(i), (j), (k), (l), (m), (n), (o). Denies the allegations in paragraphs 5(i), (j), (k), (l), (m), (n) and (o).

Denies generally and specifically each and every allegation in taxpayer's petition not hereinbefore expressly admitted, qualified or denied.

WHEREFORE, it is prayed that the petition be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
JOHN D. FOLEY,
Special Attorney,
Bureau of Internal Revenue.
10/23/28

[Endorsed]: United States Board of Tax Appeals. Filed Oct. 23, 1928. [141]

[Title of Court and Cause—Docket No. 40407.]

AMENDED PETITION.

The above named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter dated June 27, 1928, bearing the symbols IT:AR:A—1—JCC—60D, and as the basis for its appeal sets forth the following:

1. The petitioner is a corporation with principal place of business at Tustin, California.

2. The deficiency letter, copy of which is attached, was mailed to the petitioner on June 27, 1928.

3. The taxes in controversy are income taxes for the calendar years 1924 and 1925, and for approximately the following amounts:

1924	$ 2,898.43
1925	10,965.80
Total	$13,864.23

4. The determination of tax contained in said deficiency letter is based on the following errors, to-wit:

(a) The respondent erred in failing and refusing [142] to determine depreciation for the years 1924 and 1925 on walnut and citrus trees owned by the petitioner on the basis of their value at the time of acquisition on December 26, 1922.

(b) In the alternative, the respondent erred in failing and refusing to determine depreciation for the years 1924 and 1925 on walnut and citrus trees owned by the petitioner on the basis of their value on November 30, 1916.

(c) In the alternative, the respondent erred in failing and refusing to determine depreciation for the years 1924 and 1925 on value of the interest of petitioner in walnut and citrus trees, on March 1, 1913.

(d) The respondent erred in failing and refusing to allow as the basis for the sale of 46.3012

acres of land by the petitioner during the taxable year 1925, the value of such land at the time of acquisition on December 26, 1922.

(e) In the alternative, the respondent erred in failing and refusing to allow as the basis the value of such land on November 30, 1916, when acquired by the San Joaquin Fruit Company upon exercise of an option.

(f) In the alternative, the respondent erred in failing and refusing to allow as the basis the value of such land on March 1st, 1913, at which time the San Joaquin Fruit Company had an option to purchase said land.

5. The facts relied on as the basis of this appeal are as follows:

(a) The San Joaquin Fruit & Investment Co. was organized on July 12, 1922, and on November 8, 1922, issued all its authorized capital stock in exchange for all of the capital stock [143] of the San Joaquin Fruit Company, a corporation, which had been organized on or about October 5, 1906. On December 26, 1922, the San Joaquin Fruit Company was formally dissolved by order of the Superior Court of Orange County, State of California, and on December 26, 1922, all the assets of the San Joaquin Fruit Company were transferred to the San Joaquin Fruit & Investment Co.

(b) Among the assets acquired by the petitioner from the San Joaquin Fruit Company on December 26, 1922, were 600 acres of orchard land, with a total fair market value of $1,200,000.

(c) The fair market value of the trees on said lands on December 26, 1922, was at least $600,000, and their average prospective life was 18 years.

(d) The San Joaquin Fruit Company was organized on or about October 5, 1906, and acquired from The Irvine Co. (referred to hereinafter as the Lessor), a lease on 1,000 acres of unimproved land situated in Orange County, California, for a period of 10 years, beginning December 1, 1906 and ending November 30, 1916.

(e) Said lease provided for an annual rental during the period of the lease of 1/4th share of all crops, nuts and fruits grown or produced upon said land. Said agreement further contained an option to the San Joaquin Fruit Company to purchase any part or all of the leased lands on the last day of the lease at $200 per acre, payable one-fourth cash on the exercise of the option and the balance in two equal installments within three and five years respectively after date of purchase, the deferred payments to bear interest at 6 per cent per annum. [144]

(f) The San Joaquin Fruit Co. set out said 1,000 acres of land to walnut and citrus trees and at the same time installed a complete underground irrigation system, together with electric lights, electric power, sewer system, buildings, and similar improvements.

(g) On March 1, 1913, the 1,000 acres of land with the trees planted thereon, were worth at least $1,900,000, and the option owned by the San Joaquin Fruit Co. was worth, on March 1, 1913, at least $1,850,000.

(h) On November 30, 1916, the San Joaquin Fruit Co. exercised its option to purchase the 1,000 acres of land and the first payment of $75,000 provided by the contract, was made. The second and final payments of $50,000 and $75,000 were made on December 31, 1917, and October 28, 1918, respectively.

(i) On November 30, 1916, the fair market value of the land and orchards thus acquired by the San Joaquin Fruit Co. was at least $2,200,000.

(j) The fair market value of the trees on said lands on November 30, 1916, was at least $1,500,000, and their average prospective life at that date, was 24 years.

(k) The fair market value of the trees on March 1st, 1913, was at least $1,115,000, and their prospective life on that date was 27 years.

(l) On its returns for the taxable years 1924 and 1925 the petitioner claimed depreciation on said trees in the amounts of $25,246.00 and $24,620.78, based on the fair market value of said trees on March 1, 1913. [145]

(m) The respondent has allowed depreciation on said trees based only upon their actual cost before setting in the ground, at the rate of 3 per cent, or a total depreciation on account of said trees of $673.02 for each of the years 1924 and 1925.

(n) The depreciation actually sustained and deductible on said trees during each of the years 1924 and 1925 was in excess of $25,000.

(o) In December, 1925, the petitioner sold 46.3012 acres of orchard lands for a net considera-

tion of $90,390.74, upon which it reported a profit of $11,831.33. The respondent has allowed as the cost of said 46.3012 acres, together with irrigation system thereon, the total amount of $18,935.80, thereby increasing the profit by $59,623.61 to a total profit of $71,454.94.

(p) The basis of said 46.3012 acres of land to the petitioner was at least $1700 per acre, and the taxable profit from said sale, if any, was not in excess of $11,831.33.

WHEREFORE, the petitioner prays that this Board may hear the proceeding and hold that no deficiency is due by the petitioner for the taxable year 1924 or 1925, and that the petitioner is entitled to a refund of $8,429.12 for 1924, and a refund of $5,938.46 for the taxable year 1925.

GEORGE M. NAUS
155 Montgomery Street,
San Francisco, California.

[146]

N. L. McLAREN
444 California Street,
San Francisco, California.

JOSEPH D. PEELER
c/o Miller, Chevalier, Peeler & Wilson,
819 Title Insurance Building,
Los Angeles, California.

J. ROBERT SHERROD
c/o Miller & Chevalier,
922 Southern Building,
Washington, D. C.
Counsel for Petitioner.

State of California,
County of Los Angeles.—ss.

C. E. Utt, being duly sworn, says that he is President of the San Joaquin Fruit & Investment Co., the petitioner above named; that he has read the foregoing petition and that the facts stated are true.

C. E. UTT

Subscribed and sworn to before me this 23 day of May, 1932.

[Seal] MILDRED K. ROGERS
Notary Public in and for the County of Los Angeles, State of California. [147]

TREASURY DEPARTMENT
Washington

Office of
Commissioner of Internal
Revenue

June 27, 1928

San Joaquin Fruit & Investment Company,
Tustin, California.

Sirs:

In accordance with Section 274 of the Revenue Act of 1926 you are advised that the determination of your tax liability for the years 1924 and 1925 discloses a deficiency of $13,864.23, as shown in the attached statement.

The section of the law above mentioned allows you an appeal to the United States Board of Tax Ap-

peals within sixty days from the date of the mailing of this letter. However, if you acquiesce in this determination, you are requested to execute the inclosed Form A and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,

D. H. BLAIR,
Commissioner.

By (Signed) C. B. ALLEN
Deputy Commissioner.

Inclosures:
Statement.
Form A.
Form 882. [148]

STATEMENT

IT:AR:A-1
JCC-60D

In re: San Joaquin Fruit & Investment Company,
Tustin, California.

Year	Deficiency in Tax
1924	$ 2,898.43
1925	10,965.80
Total	$13,864.23

Reference is made to the report of the Internal Revenue Agent in Charge, San Francisco, California for the years 1924 and 1925, and to your protest submitted under date of April 2, 1928.

Careful consideration has been accorded your protest, in connection with the agent's findings and the adjustments recommended in the agent's report have been approved by this office.

Your contention that depreciation on trees should be computed on a March 1, 1913 value instead of cost, is denied.

Since the land upon which the trees are located was acquired subsequent to February 28, 1913, it is held by this office that the cost of trees is the correct basis for the computation of depreciation. Section 204(c) of the Revenue Acts of 1924 and 1926.

Your contention that the March 1, 1913 value of land is the correct basis for the computation of profit on the sale of land is denied.

Since the land was not acquired by the taxpayer until after February 28, 1913, it is held by this office that the correct basis for the computation of profit on the sale of land is the cost at date of acquisition. Section 204(a) of the Revenue Acts of 1924 and 1926.

1924

Net income reported	$ 67,432.99
Add:	
1. Excess depreciation on trees	24,572.98
Total	$ 92,005.97
	[149]
Brought Forward	$ 92,005.97
Deduct:	
2. Depreciaton on sundry assets	1,385.57
Net income as adjusted	$ 90,620.40

Explanation of Changes

1. Depreciation sustained on trees has been computed under the provisions of Article 161, Regulations 65. The computation is shown below:

Asset	Cost	Rate	Depreciation
Trees	$22,433.90	3%	$ 673.02
Depreciation deducted			25,246.00
Excessive depreciation			$ 24,572.98

2. Depreciation on sundry assets has been adjusted under the provisions of Article 161, Regulations 65.

Depreciation allowed	$13,436.14
Depreciation claimed	12,050.57
Additional depreciation	$ 1,385.57

The computation in detail is shown in Exhibit "B" of the revenue agent's report, a copy of which has been furnished you.

Computation of Tax

Net income	$ 90,620.40
Income tax at 12½%	$ 11,327.55
Tax previously assessed	8,429.12
Deficiency in tax	$ 2,898.43

1925

Net income reported		$ 45,680.45
Add:		
1. Excessive depreciation on trees	$23,947.76	
2. Depreciation on sundry assets	780.98	
3. Additional profit on sale of land	59,623.61	
		$ 84,352.35
Net income as adjusted		$130,032.80

[150]

Explanation of Changes

1. Depreciation sustained on trees has been computed under the provisions of Article 161, Regulations 69. The computation is shown below.

Asset	Cost	Rate	Depreciation
Trees	$22,433.90	3%	$ 673.02
Depreciation claimed			$ 24,620.78
Excessive depreciation			$ 23,947.76

2. Depreciation on sundry assets has been adjusted under the provisions of Article 161, Regulations 69.

Depreciation claimed	$ 17,166.12
Depreciation allowed	16,385.14
Excessive depreciation	$ 780.98

The computation in detail is shown in Exhibit B of the revenue agent's report, a copy of which has been furnished you.

3. The profit on the sale of land has been computed as provided in Section 204(a) of the Revenue Act of 1926.

Sale price of 46.3012 acres	$ 90,390.74
Cost of land and improvements	18,935.80
Correct profit	$ 71,454.94
Profit reported	11,831.33
Additional profit	$ 59,623.61

Computation of Tax.

Net income	$130,032.80
Income Tax at 13%	16,904.26
Tax previously assessed	5,938.46
Deficiency in tax	$ 10,965.80

Your claim for the refund of $486.66, part of income tax for 1924, has been examined.

An examination of your books and records for 1924 discloses a tax liability in excess of the amount assessed. The claim will, therefore, be rejected and the rejection will appear on a schedule to be approved by the Commissioner. [151]

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

[Endorsed]: United States Board of Tax Appeals. Filed at hearing, May 23, 1932.

A general denial was entered by the respondent as to the amended petition at the hearing on May 23, 1932. [152]

United States Board of Tax Appeals

Docket No. 42726

SAN JOAQUIN FRUIT & INVESTMENT COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter dated December 27, 1928, bearing symbols IT:AR:A-2 CLG-60D, and as the basis for its appeal sets forth the following:

1. Petitioner is a corporation with principal place of business at Tustin, California.

2. The deficiency letter, copy of which is attached is dated December 27, 1928, and was presumably mailed on same date.

3. The deficiency tax is income tax for the calendar year 1926, and as determined by the Commissioner is $12,663.58. The petitioner admits a defi-

ciency of $864.55, thereby leaving $16,799.03 in controversy.

4. The determination of tax contained in said deficiency letter is based on the following errors:

In determining the taxable income of the petitioner for the year 1926, said income was overstated to the extent of at least $122,437.22, in that—

(a) The Commissioner computed depreciation on the citrus and walnut trees owned by the petitioner in an amount of $521.08, based on their alleged cost to petitioner in the year 1916, whereas petitioner alleges that depreciation should have been computed in the amount of [153] at least $16,364.40, based either on the March 1, 1913 value of said trees or on their value when the option to purchase was exercised in the year 1916, so that the Commissioner overstated petitioner's income with respect to depreciation allowance on trees to the extent of at least $15,843.32.

(b) The Commissioner found a taxable profit on real estate sold by the petitioner of $110,230.49, based on the alleged cost to petitioner in 1916 of the property sold, whereas petitioner alleges that a profit not in excess of $17,470.76 should be determined based either on the value as of March 1, 1913 or on the value as of the year 1916, when the option to purchase was exercised, of the property sold, so that the Commissioner overstated the petitioner's income with respect to taxable profit on real estate sold to the extent of at least $92,759.73.

(c) The Commissioner allowed a loss on account of removal of walnut trees in the amount of $437.83,

based on the alleged cost of the trees to petitioner in 1916, whereas petitioner alleges that a loss should be allowed on the removal of said trees amounting to at least $142.72, based either on the March 1, 1913 value thereof or on their value in the year 1916, when the option to purchase was exercised, so that the Commissioner overstated petitioner's income with respect to removal loss on trees to the extent of at least $13,834.17.

5. The facts relied on as the basis of this appeal are as follows:

(a) On October 5, 1906, this petitioner leased from the Irvine Company, One Thousand (1,000) acres of land, agreeing to pay as rental therefor, one-fourth (¼th) of the gross proceeds received annually from said property. Said agreement further contained an option to purchase the land referred to in ten (10) years for a stipulated sum of $200,000.00. The land was at once set out to walnut and citrus trees, and at the same time, a complete underground irrigation system was installed, together with electric lights, electric power, sewer system and so forth. [154]

(b) On October 1, 1916, petitioner exercised its option to buy the land and during the period from November 17, 1916, to October 29, 1918, it paid the sum of Two Hundred Thousand Dollars ($200,000.00) therefor, in accordance with the terms of the option agreement.

(c) In the preparation of its income tax return for the year 1926 petitioner claimed a deduction of $10,544.56, on account of depreciation sustained on

citrus and walnut trees based on the March 1, 1913 value of said trees. The Commissioner disallowed the amount of depreciation so deducted and substituted therefor the amount of $521.08, based on the alleged cost of the trees to the petitioner in the year 1916, when it acquired the property through exercise of the option agreement. The petitioner now alleges that it is entitled to a depreciation on account of citrus and walnut trees for the year 1926 in the amount of at least $16,364.40, and that the Commissioner understated the allowable depreciation to which the petitioner is entitled on citrus and walnut trees to the extent of $15,843.32.

(d) During the year 1926 petitioner sold 95.978 acres of its citrus land and trees and in computing the taxable profit shown on its income tax return of $5,246.76, it used as the basis for determining said profit the March 1, 1913 value of the property sold with subsequent adjustments for depreciation, etc. It now admits that a taxable profit was realized on the sale of said land in the amount of $17,470.76. The Commissioner fixed a profit on the sale of $110,230.49 by using as the basis for determining such profit the $200,000.00 paid by the company in 1916 under the terms of the option agreement, hereinbefore mentioned, instead of the March 1, 1913 value of the property sold or its value when acquired under the option above mentioned.

(e) During the year 1926 petitioner removed walnut trees from twenty acres of its land. The March 1, 1913 value of said trees was estimated by petitioner to be $1,115.00 per acre, or a total of

$22,300.00. [155] The accumulated depreciation based on the March 1, 1913 value was computed at $8,028.00. The difference between the two amounts stated, or $14,272.00, was claimed as a loss on account of trees removed. The Commissioner reduced said loss to $437.83, based on the alleged cost to petitioner in the year 1916 of the trees removed.

(f) While it is admitted that this petitioner did not have legal title to the land and trees on March 1, 1913, and that it was operating the property under a lease from the Irvine Company, nevertheless, it is alleged that at the time the lease was entered into it was the understanding of all the parties concerned that the option to purchase embodied in the lease would be exercised, and it was because of this fact that the petitioner immediately began to develop the raw land by planting the same to citrus and walnut trees, and installing the irrigation system and other improvements above mentioned.

(g) By March 1, 1913, the trees planted had reached an approximate age of seven (7) years and were conservatively valued, exclusive of the land, at $1,115.00 per acre. When the petitioner's returns for years prior to 1922 were examined, the Revenue Agent who made the examination agreed that a value of $1,115.00 per acre for the trees alone was conservative, and it is alleged that by reason of the fact that the land and trees combined were worth approximately $1,865.00 per acre on March 1, 1913, it was clearly indicated that the petitioner intended to exercise its option to buy the land in accordance

with the terms of the option agreement, in order to secure the legal title to the property.

(h) It is further alleged that the terms and conditions under which said property was leased were entirely different from a lease of real property upon which annual crops are planted and grown, since in the latter case the value of the property is not being increased by reason of the growing of annual crops beyond the natural appreciation in value which may take place on account of the increase in population, etc., while [156] in the case of the 1,000 acres leased by this corporation from the Irvine Company, this corporation was required under the terms of the lease to plant the land to citrus and walnut trees, which fact caused the value of the real property to increase anywhere from five to ten times.

(i) By reason of the foregoing facts, it is alleged that it could very well be held that the terms and conditions under which the petitioner acquired title to the property were the same as if a contract to purchase the property had been entered into when the lease was first executed, and it had been provided that annual payments were to be made in amounts similar to those which were required to be paid as rentals under the terms of the lease with final payment to be made at the termination of the ten year period, and this was in effect what was done. In the meantime, the land was being intensively developed and this petitioner had all the rights and benefits of ownership, just the same as it would have had, had the legal title therein vested in the petitioner.

(j) If it had not been the intention of the company to exercise the option provided for and thus to acquire the legal title to the property, its officers would not have proceeded with the development of the property in such manner as to increase its value during the seven-year period from 1906 to 1913, from $200.00 per acre to a value of approximately $1,800.00 per acre.

(k) Based on the price at which similar improved property was being sold on March 1, 1913, it is alleged that the petitioner could have disposed of its interest in the property, consisting of option agreement to purchase for an amount equal to $1,800.00 per acre on March 1, 1913. [157]

(l) This petitioner had a property right in the property on March 1, 1913 equivalent to $1,800.00 per acre, which property right consisted of the option to purchase the property as described in the lease entered into with the Irvine Company and said property right would have been fully protected under the law.

(m) In the year 1916 this petitioner in effect exchanged its then valuable property right consisting of the option agreement covering the sale and purchase of the property, together with the $200,000.00 in cash, for the property itself, and thereafter its property right was represented by the land and trees rather than by the option to purchase, and it is alleged that it is justified in claiming that the basis for determining taxable profits realized on the sale of the property would be the value of the property in 1916, rather than on March 1, 1913, for the reason that the property was acquired

through an exchange in the manner set out above, which under the Revenue Act of 1916, would have been regarded as a closed transaction.

(n) In further support of its contention that it is entitled to use at least the March 1, 1913 value of the land and trees as the basis for determining taxable profit on the subsequent sale thereof and the allowable depreciation to be deducted from its gross income, the petitioner cites the Solicitor's Opinion #1110, Bulletin 1-2-705, wherein it was held that an individual who had filed on a placer mining claim prior to 1913, but who had not received patent to the land from the Government on said date, and in fact did not have his interest in said property recognized by the Government until 1920, was, nevertheless, entitled to a deduction on account of depletion sustained based on whatever value attached to the property on March 1, 1913.

(o) Reliance is also had on the decision rendered by the Board on the appeal of Arthur B. Groves, Docket No. 1159, Decision No. [158] 1187, wherein agreement entered into between a partnership and the owners of certain property under the terms of which the partnership was to sell the property, bearing all the expense of subdivision, etc., and out of the gross receipts was to pay the owners of the property a fixed amount, was construed as an agreement or contract covering the sale of the property by the owner to the partnership, so that the partnership was entitled to consider that it had an interest in the property as of March 1, 1913, and to set up a value as of that date for the purpose of determining profit on the sale of said property.

WHEREFORE, this petitioner prays that this Board may hear its petition and find that the deficiency in tax proposed by the Commissioner should not be asserted.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY,
By C. E. UTT, Pres.
CLAUDE I. PARKER, Atty.,
B.
910-912 Investment Bldg.,
Washington, D. C.

State of California,
County of Orange—ss.

C. E. Utt, of the City of Tustin, State and County aforesaid, being first duly sworn upon his oath deposes and says that he is president of the San Joaquin Fruit & Investment Company, a corporation with principal place of business at Tustin, California, and that said corporation is the petitioner referred to in the foregoing petition and that he has read the said petition or has had the same read to him and is familiar with the statements therein contained and that the facts therein stated are true and correct, except such facts as are stated to be on information and belief and those facts he believes to be true.

C. E. UTT.

Subscribed and sworn to before me this 31st day of January, 1929.

MARGUERITE LESAGE,
Notary Public in and for the County of Orange, State of California. [159]

TREASURY DEPARTMENT
Washington

Dec. 27, 1928.

Office of
Commissioner of Internal
Revenue
Address Reply to
Commissioner of Internal Revenue
and refer to
IT:AR:A-2
CLG-60D
San Joaquin Fruit and Investment Company,
Tustin, California.

Sirs:

In accordance with Section 274 of the Revenue Act of 1926 you are advised that the determination of your tax liability for the year 1926 discloses a deficiency of $17,663.58, as shown in the attached statement.

The section of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter for a redetermination of your tax liability. However, if you acquiesce in this determination, you are requested to execute the enclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,
D. H. BLAIR,
Commissioner,
By W. T. SHERWOOD
Acting Deputy Commissioner.

Enclosures:
Statement
Form 866
Form 882 [160]

STATEMENT

IT:AR:A-2
CLG-60D

In re: San Joaquin Fruit and Investment Company,
Tustin, California,

Year	Deficiency in Tax
1926	$17,663.58

Tax reported on return	$ 1,192.44
Proposed deficiency	17,663.58
Liability stated on Form 866	$18,856.02

Reference is made to the report of the Internal Revenue Agent in Charge, San Francisco, California, and to your protest submitted under date of September 23, 1928.

Careful consideration has been accorded your protest in connection with the agent's findings and the adjustments recommended by the agent have been approved by this office.

Net income reported on return	$ 10,832.87
Additions:	
1. Depreciation on trees disallowed	10,023.48
2. Additional profit on sale of land	104,983.73
3. Loss disallowed on removal of trees	13,834.17
Net income as adjusted	139,674.25

Explanation of Adjustments

1. This adjustment, under Article 161 of Regulations 69, was explained in detail in Schedule 1-a

of the Revenue Agent's report, a copy of which was furnished you.

Depreciation taken on trees	$ 10,544.52
Depreciation allowed	521.04
Net depreciation disallowed	$ 10,023.48

2. The profit realized on sale of land has been computed in accordance with Article 1591 of Regulations 69.

Corrected profit on land sold	$110,230.49
Profit as reported	5,246.76
Additional profit	$104,983.73

[161]

3. The loss deducted on account of removal of trees has been adjusted in accordance with Article 141 of Regulations 69.

Removal loss taken	$ 14,272.00
Removal loss allowed	437.83
Amount disallowed	$ 13,834.17

Computation of Tax

Net income as adjusted	$139,674.25
Income tax at 13½%	18,856.02
Tax previously assessed	1,192.44
Deficiency in tax	17,663.58

Inasmuch as the only issue involved is now before the United States Board of Tax Appeals for prior

years, this letter is issued giving you the right to file a petition for this year.

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

[Endorsed]: United States Board of Tax Appeals. Filed Feb. 14, 1929. [162]

[Title of Court and Cause—Docket No. 42726.]

ANSWER.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1, 2. Admits the allegations in paragraphs 1 and 2.

3. Admits the allegations in paragraph 3, except that he says the deficiency in income tax for the year 1926 as determined by the Commissioner is $17,663.58 and not $12,663.58.

5, (a), (b) For lack of information upon which to base a belief, denies the allegations in paragraphs 5, (a) and (b).

5, (c) Admits that the petitioner claimed as a deduction from gross income on its income tax return for the year 1926 the amount of $10,544.56, alleged depreciation on citrus and walnut trees. Admits that the Commissioner disallowed the amount of depreciation so deducted and substituted

therefor the amount of $521.04. Denies the remaining allegations in paragraph 5, (c).

5, (d) Admits that the petitioner showed the amount of $5,246.76 as taxable profit from the sale of certain citrus land and trees on its income tax return for the year 1926. Admits that the Commissioner fixed a profit on said sale in the amount of $110,230.49. Denies the remaining allegations in paragraph 5, (d). [163]

5, (e) Admits that the petitioner claimed as a deduction on its return for the calendar year 1926, the amount of $14,272. alleged loss on account of trees removed. Admits that the Commissioner reduced said alleged loss to $437.83. Denies the remaining allegations in paragraph 5, (e).

5, (f), (g), (h), (i), (j), (k), (l), (m), (n), (o), Denies the allegations in paragraphs, 5 (f), (g), (h), (i), (j), (k), (l), (m), (n) and (o).

Denies generally and specifically each and every allegation in taxpayer's petition not hereinbefore expressly admitted, qualified or denied.

WHEREFORE, it is prayed that the petition be denied.

(Signed) C. M. CHAREST
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
JOHN D. FOLEY,
Special Attorney,
Bureau of Internal Revenue.
4/16/29

[Endorsed]: United States Board of Tax Appeals. Filed Apr. 16, 1929. [164]

[Title of Court and Cause—Docket No. 42726.]

AMENDED PETITION.

The above named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter dated December 27, 1928, bearing the symbols IT:AR:A—2—CLG—60D, and as the basis of its appeal sets forth the following:

1. The petitioner is a corporation with principal place of business at Tustin, California.

2. The deficiency letter, copy of which is attached, was mailed to the petitioner on December 27, 1928.

3. The taxes in controversy are income taxes for the calendar year 1926, and in the amount of approximately $18,000.00.

4. The determination of tax contained in said deficiency is based on the following errors, to-wit:

(a) The respondent erred in failing and refusing to determine depreciation for the year 1926 on walnut and citrus trees owned by the petitioner on the basis of their value at the time of acquisition on December 26, 1922.

(b) In the alternative, the respondent erred in failing and refusing to determine depreciation for the year 1926 on walnut [165] and citrus trees owned by the petitioner on the basis of their value on November 30, 1916.

(c) In the alternative, the respondent erred in failing and refusing to determine depreciation for the year 1926 on value of the interest of petitioner in walnut and citrus trees on March 1, 1913.

(d) The respondent erred in failing and refusing to allow as the basis for the sale of 95.978 acres of land by the petitioner during the taxable year 1926, the value of such land at the time of acquisition on December 26, 1922.

(e) In the alternative, the respondent erred in failing and refusing to allow as the basis the value of such land on November 30, 1916, when acquired by the San Joaquin Fruit Co. upon exercise of an option.

(f) In the alternative, the respondent erred in failing and refusing to allow as the basis the value of such land on March 1, 1913, at which time the San Joaquin Fruit Co. had an option to purchase said land.

(g) The respondent erred in disallowing a loss of $13,834.17 sustained by petitioner upon removal of trees during the taxable year 1926.

5. The facts relied on as the basis of this appeal are as follows:

(a) The San Joaquin Fruit & Investment Co. was organized on July 12, 1922, and on November 8, 1922, issued all its authorized capital stock in exchange for all of the capital stock of the San Joaquin Fruit Co., a corporation, which had been organized on or about October 5, 1906. On December 26, 1922, the San Joaquin Fruit [166] Co. was formally dissolved by order of the Superior Court of Orange County, State of California, and on December 26, 1922, all the assets of the San Joaquin Fruit Co. were transferred to the San Joaquin Fruit & Investment Co.

(b) Among the assets acquired by the petitioner from the San Joaquin Fruit Co. on December 26, 1922, were 600 acres of orchard land, with a total fair market value of $1,200,000.

(c) The fair market value of the trees on said lands on December 26, 1922, was at least $600,000, and their average prospective life was 18 years.

(d) The San Joaquin Fruit Co. was organized on or about October 5, 1906, and acquired from The Irvine Co. (referred to hereinafter as the Lessor), a lease on 1,000 acres of unimproved land situated in Orange County, California, for a period of 10 years, beginning December 1, 1906, and ending November 30, 1916.

(e) Said lease provided for an annual rental during the period of the lease of ¼th share of all crops, nuts and fruits grown or produced upon said land. Said agreement further contained an option to the San Joaquin Fruit Co. to purchase any part or all of the leased lands on the last day of the lease at $200 per acre, payable one-fourth cash on the exercise of the option and the balance in two equal installments within three and five years respectively after date of purchase, the deferred payments to bear interest at 6 per cent per annum.

(f) The San Joaquin Fruit Co. set out said 1,000 acres of land to walnut and citrus trees and at the same time installed a complete underground irrigation system, together with electric [167] lights, electric power, sewer system, buildings, and similar improvements.

(g) On March 1, 1913, the 1,000 acres of land with the trees planted thereon, were worth at least $1,900,000, and the option owned by the San Joaquin Fruit Co. was worth, on March 1, 1913, at least $1,850,000.

(h) On November 30, 1916, the San Joaquin Fruit Co. exercised its option to purchase the 1,000 acres of land and the first payment of $75,000 provided by the contract, was made. The second and final payments of $50,000 and $75,000 were made on December 31, 1917, and October 28, 1918, respectively.

(i) On November 30, 1916, the fair market value of the land and orchards thus acquired by the San Joaquin Fruit Co. was at least $2,200,000.

(j) The fair market value of the trees on said lands on November 30, 1916, was at least $1,500,000, and their average prospective life at that date, was 24 years.

(k) The fair market value of the trees on March 1, 1913, was at least $1,115,000, and their prospective life on that date was 27 years.

(l) On its return for the taxable year 1926, the petitioner claimed depreciation on said trees in the amount of $10,544.52, based on the fair market value of said trees on March 1, 1913.

(m) The respondent in his deficiency notice has allowed depreciation on said trees based only upon their actual cost before setting in the ground, at the rate of 3 per cent, or a total [168] depreciation on account of said trees of $521.08 for the taxable year 1926.

(n) The depreciation actually sustained and deductible on said trees during the year 1926, was in excess of $10,544.52.

(o) During the taxable year 1926 the petitioner sold 95.978 acres of land for a net consideration of $180,709.69, upon which it reported a profit of $5,246.76. The respondent has allowed as the cost of said 95.978 acres of land, together with irrigation system thereon, and cost of removing old walnut trees and planting orange trees, the total amount of $70,479.20, thereby increasing the profit by $104,983.73 to a total profit of $110,230.49.

(p) The basis of said 95.978 acres of land was at least $180,709.69 and no taxable profit was realized from said sale.

(q) During the taxable year 1926, the petitioner removed walnut trees from 20 acres of its land, sustaining thereby a loss of $14,272.00, which was deducted on its return. The respondent has erroneously disallowed $13,834.17 of this loss, allowing only $437.83.

WHEREFORE, the petitioner prays that this Board may hear the proceeding and hold that no deficiency is due by the petitioner for the taxable year 1926, and that the petitioner is entitled to a refund of $1,192.44 for the taxable year 1926.

GEORGE M. NAUS,
155 Montgomery Street,
San Francisco, California.
N. L. McLAREN,
444 California Street,
San Francisco, California.

[169]

JOSEPH D. PEELER,
c/o Miller, Chevalier, Peeler
& Wilson,
819 Title Insurance Building,
Los Angeles, California.
J. ROBERT SHERROD,
c/o Miller & Chevalier,
922 Southern Building,
Washington, D. C.
Counsel for Petitioner.

State of California,
County of Los Angeles—ss.

C. E. Utt, being duly sworn, says that he is President of the San Joaquin Fruit & Investment Co., the petitioner above named; that he has read the foregoing petition and that the facts stated are true.

C. E. UTT.

Subscribed and sworn to before me this 23 day of May, 1932.

[Seal] MILDRED K. ROGERS,
Notary Public in and for the County of
Los Angeles, State of California. [170]

TREASURY DEPARTMENT
Washington

Dec. 27, 1928.

Office of
Commissioner of Internal
Revenue
Address Reply to
Commissioner of Internal Revenue
and refer to
San Joaquin Fruit and Investment Company,
Tustin, California.

Sirs:

In accordance with Section 274 of the Revenue Act of 1926 you are advised that the determination of your tax liability for the year 1926 discloses a deficiency of $17,663.58, as shown in the attached statement.

The section of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter for a redetermination of your tax liability. However, if you acquiesce in this determination, you are requested to execute the enclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,
D. H. BLAIR,
Commissioner,
By (Signed) N. T. SHERWOOD
Acting Deputy Commissioner.

Enclosures:
Statement
Form 866
Form 882 [171]

STATEMENT

IT:AR:A-2
CLG-60D

In re: San Joaquin Fruit and Investment Company,
Tustin, California,

Year	Deficiency in Tax
1926	$17,663.58

Tax reported on return	$ 1,192.44
Proposed deficiency	17,663.58
Liability stated on Form 866	$18,856.02

Reference is made to the report of the Internal Revenue Agent in Charge, San Francisco, California, and to your protest submitted under date of September 23, 1928.

Careful consideration has been accorded your protest in connection with the agent's findings and the adjustments recommended by the agent have been approved by this office.

Net income reported on return	$ 10,832.87
Additions:	
1. Depreciation on trees disallowed	10,023.48
2. Additional profit on sale of land	104,983.73
3. Loss disallowed on removal of trees	13,834.17
Net income as adjusted	$139,674.25

Explanation of Adjustments

1. This adjustment, under Article 161 of Regulations 69, was explained in detail in Schedule 1-a

of the Revenue Agent's report, a copy of which was furnished you.

Depreciation taken on trees	$10,544.52
Depreciation allowed	521.04
Net depreciation disallowed	$10,023.48

2. The profit realized on sale of land has been computed in accordance with Article 1591 of Regulations 69.

Corrected profit on land sold	$110,230.49
Profit as reported	5,246.76

3. The loss deducted on account of removal of trees has [172] been adjusted in accordance with Article 141 of Regulations 69.

Removal loss taken	$14,272.00
Removal loss allowed	437.83
Amount disallowed	$13,834.17

Computation of Tax

Net income as adjusted	$139,674.25
Income tax at 13½%	18,856.02
Tax previously assessed	1,192.44
Deficiency in tax	$ 17,663.58

Inasmuch as the only issue involved is now before the United States Board of Tax Appeals for prior years, this letter is issued giving you the right to file a petition for this year.

Payment should not be made until a bill is received from the Collector of Internal Revenue for

your district, and remittance should then be made to him.

[Endorsed]: United States Board of Tax Appeals. Filed at hearing, May 23, 1932.

A general denial was entered by the respondent as to the amended petition at the hearing on May 23, 1932. [173]

United States Board of Tax Appeals

Docket No. 49317

SAN JOAQUIN FRUIT & INVESTMENT COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above-named petitioner hereby appeals from the determination of the Commissioner set forth in his deficiency letter dated May 1, 1930, bearing symbols IT:AR:C-4 HBE-60D, and as the basis of its appeal sets forth the following:

1. Petitioner is a corporation with principal place of business at Tustin, California.

2. The deficiency letter copy of which is attached is dated May 1, 1930, and was presumably mailed on same date.

3. The deficiency tax is income tax for the calendar year 1927 and is in excess of $10,000.00, to wit: $20,177.14.

4. The determination of tax contained in said deficiency letter is based on the following errors:

In determining the taxable income of petitioner for the year 1927, said income was overstated to the extent of at least $149,460.32, in that

(a) The Commissioner found a taxable profit on real estate sold by petitioner of $212,792.88, based on an alleged cost to petitioner in 1916 of the property sold, with subsequent adjustments to date of sale, whereas petitioner alleges that a [174] profit not in excess of $66,263.60, should be determined based either on the value as of March 1, 1913 or on the value as of the year 1916 when an option to purchase was exercised, of the property sold, so that the Commissioner overstated the petitioner's income with respect to taxable profit on real estate sold to the extent of at least $146,529.28, and

(b) The Commissioner computed depreciation on citrus and walnut trees owned by petitioner in an amount of $4,224.24, based on their alleged cost to petitioner in the year 1916, whereas petitioner alleges that depreciation should have been computed in the amount of at least $7,155.28, based either on the March 1, 1913 value of said trees or on their value when an option to purchase was exercised in the year 1916, so that the Commissioner overstated petitioner's income with respect to depreciation allowance on trees to the extent of at least $2,931.04.

5. The facts relied on as the basis of this appeal are as follows:

(a) On October 5, 1906, this petitioner leased from the Irvine Company, One Thousand (1,000) acres of land, agreeing to pay as rental therefor, one-fourth (¼) of the gross proceeds received annually from said property. Said agreement further contained an option to purchase the land referred to in ten (10) years for a stipulated sum of $200,000.00. The land was a once set out to walnut and citrus trees, and at the same time, a complete underground irrigation system was installed, together with electric lights, electric, power, sewer system and so forth.

(b) On Ocober 1, 1916, petitioner exercised its option to buy the land and during the period from November 17, 1916, [175] to October 29, 1918, it paid the sum of Two Hundred Thousand Dollars ($200,000.00) therefor, in accordance with the terms of the option agreement.

(c) During the year 1927 petitioner sold 138.387 acres of its citrus land and trees and in computing the taxable profit shown on its income tax return of $66,263.60, it used as the basis for determining said profit the March 1, 1913 value of the property sold with subsequent adjustments for depreciation, etc. The Commissioner fixed a profit on the sale of $212,792.88 by using as the basis for determining such profit the amount paid by the company in 1916 under the terms of the option agreement, hereinbefore mentioned, instead of the March 1, 1913 value

of the property sold or its value when acquired under the option above mentioned.

(d) In the preparation of its income tax return for the year 1927 petitioner claimed a deduction of $7,155.28, on account of depreciation sustained on citrus and walnut trees based on the March 1, 1913 value of said trees. The Commissioner disallowed the amount of depreciation so deducted and substituted therefor the amount of $4,224.24, based on the alleged cost of the trees to the petitioner in the year 1916, when it acquired the property through exercise of the option agreement. The petitioner now alleges that it is entitled to a depreciation on account of citrus and walnut trees for the year 1927 in the amount of at least $7,155.28, and that the Commissioner understated the allowable depreciation to which the petitioner is entitled on citrus and walnut trees to the extent of $2,931.04.

(e) While it is admitted that this petitioner did not have legal title to the land and trees on March 1, 1913, and [176] that it was operating the property under a lease from the Irvine Company, nevertheless, it is alleged that at the time the lease was entered into it was the understanding of all the parties concerned that the option to purchase embodied in the lease would be exercised, and it was because of this fact that the petitioner immediately began to develop the raw land by planting the same to citrus and walnut trees, and installing the irrigation system and other improvements above mentioned.

(f) By March 1, 1913, the trees planted had reached an approximate age of seven (7) years and were conservatively valued, exclusive of the land, at $1,115.00 per acre. When the petitioner's returns for years prior to 1922 were examined, the Revenue Agent who made the examination agreed that a value of $1,115.00 per acre for the trees alone was conservative, and it is alleged that by reason of the fact that the land and trees combined were worth approximately $1,865.00 per acre on March 1, 1913, it was clearly indicated that the petitioner intended to exercise its option to buy the land in accordance with the terms of the option agreement, in order to secure the legal title to the property.

(g) It is further alleged that the terms and conditions under which said property was leased were entirely different from a lease of real property upon which annual crops are planted and grown, since in the latter case the value of the property is not being increased by reason of the growing of annual crops beyond the natural appreciation in value which may take place on account of the increase in population, etc., while in the case of the 1,000 acres leased by this corporation from the Irvine Company, this corporation was required under the terms of the lease to plant the [177] land to citrus and walnut trees, which fact caused the value of the real property to increase anywhere from five to ten times.

(h) By reason of the foregoing facts, it is alleged that it could very well be held that the terms and conditions under which the petitioner acquired

title to the property were the same as if a contract to purchase the property had been entered into when the lease was first executed, and it had been provided that annual payments were to be made in amounts similar to those which were required to be paid as rentals under the terms of the lease with final payment to be made at the termination of the ten-year period, and this was in effect what was done. In the meantime, the land was being intensively developed and this petitioner had all the rights and benefits of ownership, just the same as it would have had, had the legal title therein vested in the petitioner.

(i) If it had not been the intention of the company to exercise the option provided for and thus to acquire the legal title to the property, its officers would not have proceeded with the development of the property in such manner as to increase its value during the seven-year period from 1906 to 1913, from $200.00 per acre to a value of approximately $1,800.00 per acre.

(j) Based on the price at which similar improved property was being sold on March 1, 1913, it is alleged that the petitioner could have disposed of its interest in the property, consisting of option agreement to purchase for an amount equal to $1,800.00 per acre on March 1, 1913.

(k) This petitioner had a property right in the property on March 1, 1913 equivalent to $1,800.00 per acre, which [178] property right consisted of the option to purchase the property as described in the lease entered into with the Irvine Company

and said property right would have been fully protected under the law.

(l) In the year 1916 this petitioner in effect exchanged its then valuable property right consisting of the option agreement covering the sale and purchase of the property, together with the $200,000.00 in cash, for the property itself and thereafter its property right was represented by the land and trees rather than by the option to purchase, and it is alleged that it is justified in claiming that the basis for determining taxable profits realized on the sale of the property would be the value of the property in 1916, rather than on March 1, 1913, for the reason that the property was acquired through an exchange in the manner set out above, which under the Revenue Act of 1916, would have been regarded as a closed transaction.

(m) In further support of its contention that it is entitled to use at least the March 1, 1913 value of the land and trees as the basis for determining taxable profit on the subsequent sale thereof and the allowable depreciation to be deducted from its gross income, the petitioner cites the Solicitor's Opinion #1110, Bulletin 1-2-705, wherein it was held that an individual who had filed on a placer mining claim prior to 1913, but who had not received patent to the land from the Government on said date, and in fact did not have his interest in said property recognized by the Government until 1920, was, nevertheless, entitled to a deduction on account of depletion sustained based on whatever

value attached to the property on March 1, 1913. [179]

(n) Reliance is also had on the decision rendered by the Board on the appeal of Arthur B. Groves, Docket No. 1159, Decision No. 1187, wherein agreement entered into between a partnership and the owners of certain property under the terms of which the partnership was to sell the property, bearing all the expense of subdivision, etc., and out of the gross receipts was to pay the owners of the property a fixed amount, was construed as an agreement or contract covering the sale of the property by the owner to the partnership, so that the partnership was entitled to consider that it had an interest in the property as of March 1, 1913, and to set up a value as of that date for the purpose of determining profit on the sale of said property.

WHEREFORE, this petitioner prays that this Board may hear its petition and find that the deficiency in tax proposed by the Commissioner should not be asserted.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY,
By C. E. Utt,
President.

JOHN B. MILLIKEN,
Counsel for Petitioner.
937 Munsey Bldg.,
Washington, D. C.

State of California,
County of Orange—ss.

C. E. Utt, of the City of Tustin, State and County aforesaid, being first duly sworn upon his oath deposes and says that he is president of the San Joaquin Fruit & Investment Company, a corporation with principal place of business at Tustin, California, and that said corporation is the petitioner referred to in the foregoing petition and that he has read the said petition or has had the same read to him and is familiar with the statements therein [180] contained and that the facts therein stated are true and correct, except such facts as are stated to be on information and belief and those facts he believes to be true.

(Signed) C. E. UTT.

Subscribed and sworn to before me this 16th day of June, 1930.

(Signed) MARGUERITE LESAGE,
Notary Public in and for the County of Orange, State of California. [181]

TREASURY DEPARTMENT
Washington

Office of
Commissioner of Internal Revenue
Address reply to
Commissioner of Internal Revenue
And refer to
San Joaquin Fruit and Investment Company,
c/o Claude I. Parker,
Eighth Floor, Bank of America Building,
Los Angeles, California.

May 1, 1930

Sirs:

In accordance with Section 274 of the Revenue Act of 1926, you are advised that the determination of your tax liability for the years 1927 discloses a deficiency of $20,177.14, as shown in the statement attached.

The section of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the inclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement form will expedite the closing of your return by permitting an early assessment of any deficiencies and preventing the accumulation of interest charges, since the interest

period terminates thirty days after filing the agreement form, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiencies.

Respectfully,
ROBT. H. LUCAS,
Commissioner.
By (Signed) DAVID BURNET
Deputy Commissioner.

Inclosures:
Statement
Form 866
Form 882
Form 7928-Rev. Dec. 1928. [182]

STATEMENT

IT:AR:C-4
HBE-60D
In re: San Joaquin Fruit and Investment Company
c/o Claude I. Parker,
Eight Floor, Bank of America Building,
Los Angeles, California.

	Tax Liability		
Year	Corrected Tax Liability	Tax Previously Assessed	Deficiency
1927	$28,603.30	$8,426.16	$20,177.14

Reference is made to the report of the internal revenue agent in charge, San Francisco, California,

and to your protest submitted under date of October 12, 1929.

Careful consideration has been accorded your protest in connection with the agent's report. The adjustments recommended by the agent have been approved by this office.

Your contention that in determining the amount of profit from the sale of real estate, the March 1, 1913 value of $75.00 per acre should be used, has been denied. It is held that the depreciated cost as at December 31, 1925 of $408.97 per acre is the correct basis to be used in determining the profit realized from the sale, in accordance with the provisions of Section 204 of the Revenue Act of 1926.

Net income reported in the return	$62,415.99
Add:	
1. Profit on sale of real estate	146,529.28
2. Excessive depreciation	2,931.04
Net income as adjusted	$211,876.31

Explanation of Adjustments

1. Profit from the sale of real estate has been adjusted in accordance with the provisions of section 204 of the Revenue Act of 1926. The computations are as follows: [183]

Depreciated cost per acre as of December 31, 1925 is $408.97, including irrigation system and trees. This value is the same as used in computing the adjusted profit in prior years.

Sale price		$303,641.35
Cost 138.387 acres at $408.97	$56,596.13	
Water stock	9,556.40	
Cost of moving old walnut trees	21,808.31	
Cost of trees removed	2,465.53	
Cost of right of way	510.00	
Tent house	843.44	
Total	$91,779.81	
Less:		
Depreciation for 1926 on 138.837 acres at $6.73	931.34	90,848.47
Profit realized		$212,792.88
Profit reported in return		66,263.60
Additional profit		$146,529.28

2. Depreciation has been adjusted in accordance with the provisions of section 214(a) (8) of the Revenue Act of 1926. The computations are as follows:

Depreciation adjustment on trees that had been sold up to January 1, 1927, on 512.0292 acres of the 1,000 acre tract and in 1927 there were sold 138,387 acres leaving a balance of unsold acreage of 349.584 acres.

349.584 acres trees at $35.60 per acre	$12,445.19
Value of above trees, $12,445.19 at 3%	$ 373.36
New trees, $128,362.59 at 3%	3,850.88
Depreciation allowable	$ 4,224.24
Depreciation claimed in return	7,155.28
Excessive depreciation restored to income	$ 2,931.04

[184]

Computation of Tax

Net income as adjusted	$211,876.31
Tax at 13½%	$ 28,603.30
Previously assessed	8,426.16
Deficiency	$ 20,177.14

Since the issues involved are pending before the United States Board of Tax Appeals in connection with your tax liability for the years prior to 1927 and further consideration by this office would not result in any change in the findings set forth herein, this final notice under the provisions of section 274 of the Revenue Act of 1926 is issued without affording you opportunity for a conference.

A copy of this communication has been furnished your authorized representative, Mr. Claude I. Parker, Eighth Floor, Bank of America Building, Los Angeles, California.

[Endorsed]: United States Board of Tax Appeals. Filed June 20, 1930. [185]

[Title of Court and Cause—Docket No. 49317.]

ANSWER.

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above named taxpayer, admits and denies, as follows:

1. Admits the allegations of paragraph (1).
2. Admits the allegations of paragraph (2).
3. Admits the allegations of paragraph (3).
4. Denies that the Commissioner committed the errors alleged in paragraph (4).
5. (a) and (b). Denies the allegations of subparagraphs (a) and (b) of paragraph (5).

(c) Admits that the petitioner reported an amount of $66,273.60 as profit from the sale of certain citrus land and trees on its income tax return for the calendar year 1927. Admits that the respondent computed the profit on such sale in the amount of $212,792.88. Denies the remaining allegations of subparagraph (c) of paragraph (5).

(d) Admits that the petitioner deducted depreciation on citrus and [186] walnut trees in the amount of $7,155.28 on its income tax return for the calendar year 1927. Admits that the respondent disallowed the amount of depreciation so deducted and substituted therefor the amount of $4,224.24. Denies the remaining allegations of subparagraph (d) of paragraph (5).

(e) to (n), inclusive. Denies the allegations of subparagraphs (e), (f), (g), (h), (i), (j), (k), (l), (m) and (n) of paragraph (5).

Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified, or denied.

WHEREFORE, it is prayed that the appeal be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
JOHN D. FOLEY,
Special Attorney,
Bureau of Internal Revenue.

lmb
8/19/30.

[Endorsed]: United States Board of Tax Appeals. Filed Aug. 20, 1930. [187]

[Title of Court and Cause—Docket No. 49317.]

AMENDED PETITION.

The above named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter dated May 1, 1930, bearing the symbols IT:AR:C-4-JBE-60D, and as the basis for its appeal sets forth the following:

1. The petitioner is a corporation with principal place of business at Tustin, California.

2. The deficiency letter, copy of which is attached, was mailed to the petitioner on May 1, 1930.

3. The taxes in controversy are income taxes for the calendar year 1927, in the amount of $20,177.14.

4. The determination of tax contained in said deficiency letter is based on the following errors, to-wit:

(a) The respondent erred in failing and refusing to determine depreciation for the year 1927 on walnut and citrus trees owned by the petitioner on the basis of their value at the time of acquisition on December 26, 1922.

(b) In the alternative, the respondent erred in fail- [188] ing and refusing to determine depreciation for the year 1927 on walnut and citrus trees owned by the petitioner on the basis of their value on November 30, 1916.

(c) In the alternative, the respondent erred in failing and refusing to determine depreciation for the year 1927 on value of the interest of petitioner in walnut and citrus trees on March 1, 1913.

(d) The respondent erred in failing and refusing to allow as the basis for the sale of 138.387 acres of land by the petitioner during the taxable year 1927, the value of such land at the time of acquisition on December 26, 1922.

(e) In the alternative, the respondent erred in failing and refusing to allow as the basis the value of such land on November 30, 1916, when acquired by the San Joaquin Fruit Co. upon exercise of an option.

(f) In the alternative, the respondent erred in failing and refusing to allow as the basis the value of such land on March 1, 1913, at which time the

San Joaquin Fruit Co. had an option to purchase said land.

5. The facts relied on as the basis of this appeal are as follows:

(a) The San Joaquin Fruit & Investment Co. was organized on July 12, 1922, and on November 8, 1922, issued all its authorized capital stock in exchange for all of the capital stock of the San Joaquin Fruit Co., a corporation, which had been organized on or about October 5, 1906. On December 26, 1922, the San Joaquin Fruit Co. was formally dissolved by order of the Superior Court of Orange County, State of California, and on December 26, [189] 1922, all the assets of the San Joaquin Fruit Co. were transferred to the San Joaquin Fruit & Investment Co.

(b) Among the assets acquired by the petitioner from the San Joaquin Fruit Co. on December 26, 1922, were 600 acres of orchard land, with a total fair market value of $1,200,000.

(c) The fair market value of the trees on said lands on December 26, 1922, was at least $600,000, and their average prospective life was 18 years.

(d) The San Joaquin Fruit Co. was organized on or about October 5, 1906, and acquired from The Irvine Co. (referred to hereinafter as the Lessor), a lease on 1,000 acres of unimproved land situated in Orange County, California, for a period of 10 years, beginning December 1, 1906 and ending November 30, 1916.

(e) Said lease provided for an annual rental during the period of the lease of ¼th share of all

crops, nuts and fruits grown or produced upon said land. Said agreement further contained an option to the San Joaquin Fruit Company to purchase any part or all of the leased lands on the last day of the lease at $200 per acre, payable one-fourth cash on the exercise of the option and the balance in two equal installments within three and five years respectively after date of purchase, the deferred payments to bear interest at 6 per cent per annum.

(f) The San Joaquin Fruit Co. set out said 1,000 acres of land to walnut and citrus trees and at the same time installed a complete underground irrigation system, together with electric lights, electric power, sewer system, buildings, and similar improvements. [190]

(g) On March 1, 1913, the 1,000 acres of land with the trees planted thereon, were worth at least $1,900,000, and the option owned by the San Joaquin Fruit Co. was worth, on March 1, 1913, at least $1,850,000.

(h) On November 30, 1916, the San Joaquin Fruit Co. exercised its option to purchase the 1,000 acres of land and the first payment of $75,000 provided by the contract, was made. The second and final payments of $50,000 and $75,000 were made on December 31, 1917, and October 28, 1918, respectively.

(i) On November 30, 1916, the fair market value of the land and orchards thus acquired by the San Joaquin Fruit Co. was at least $2,200.000.

(j) The fair market value of the trees on said lands on November 30, 1916, was at least $1,500,000,

and their average prospective life at that date, was 24 years.

(k) The fair market value of the trees on March 1, 1913, was at least $1,115,000, and their prospective life on that date was 27 years.

(l) On its return for the taxable year 1927, the petitioner claimed depreciation on its trees in the amount of $3,304.40, based on the fair market value of said trees on March 1, 1913.

(m) The respondent has allowed depreciation on said trees based only upon their actual cost before setting in the ground, at the rate of 3 per cent, or a total depreciation on account of said trees of $373.36 for the year 1927.

(n) The depreciation actually sustained and deductible on said trees during the year 1927 was in excess of $3,304.40. [191]

(o) During the taxable year 1927 the petitioner sold 138.387 acres of orchard lands, including irrigation system and trees, for a net consideration of $303,641.35, upon which it reported a profit of $66,203.60. The respondent has allowed as the cost of said 138.387 acres of land, together with irrigation system thereon, and cost of removing old trees, etc., the total amount of $90,848.47, thereby increasing the profit by $146,529.28 to a total profit of $212,792.88.

(p) The basis of said 138.398 acres of land to the petitioner was at least $303,641.35, and no taxable profit was realized from the sale.

WHEREFORE, the petitioner prays that this Board may hear the proceeding and hold that no

deficiency is due by the petitioner for the taxable year 1927, and that the petitioner is entitled to a refund of $8,426.16 for the taxable year 1927.

GEORGE M. NAUS,
155 Montgomery Street,
San Francisco, California.
N. L. McLAREN,
444 California Street,
San Francisco, California.
JOSEPH D. PEELER,
c/o Miller, Chevalier, Peeler & Wilson,
819 Title Insurance Building,
Los Angeles, California. [192]
J. ROBERT SHERROD,
c/o Miller & Chevalier,
922 Southern Building,
Washington, D. C.
Counsel for Petitioner.

State of California,
County of Los Angeles.—ss.

C. E. Utt, being duly sworn, says that he is President of the San Joaquin Fruit & Investment Co., the petitioner above named; that he has read the foregoing petition and that the facts stated are true.

C. E. UTT

Subscribed and sworn to before me this 23 day of May, 1932.

[Seal] MILDRED K. ROGERS
Notary Public in and for the County of Los Angeles, State of California. [193]

[Seal]

TREASURY DEPARTMENT
Washington

May 1, 1930

Office of
Commissioner of Internal
Revenue
Address reply to
Commissioner of Internal Revenue
And refer to
IT:AR:C-4
HBE-60D

San Joaquin Fruit and Investment Company,
c/o Claude I. Parker,
Eighth Floor, Bank of America Building,
Los Angeles, California.

Sirs:

In accordance with Section 274 of the Revenue Act of 1926, you are advised that the determination of your tax liability for the years 1927 discloses a deficiency of $20,177.14, as shown in the statement attached.

The section of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the enclosed Form 866 and forward both the original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

The signing of this agreement form will expedite the closing of your return by permitting an early assessment of any deficiencies and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the agreement form, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiencies.

Respectfully,

ROBT. H. LUCAS,

Commissioner.

By (Signed) DAVID BURNET

Deputy Commissioner.

Inclosures:

Statement EAH-2

Form 866

Form 882 [194]

STATEMENT

IT:AR:C-4

HBE-60D

In re: San Joaquin Fruit & Investment Company,
c./o Claude I. Parker,
Eighth Floor, Bank of America Building,
Los Angeles, California.

Tax Liability

Year	Corrected Tax Liability	Tax Previously Assessed	Deficiency
1927	$28,603.30	$8,426.16	$20,177.14

Reference is made to the report of the internal revenue agent in charge, San Francisco, California, and to your protest submitted under date of October 12, 1929.

Careful consideration has been accorded your protest in connection with the agent's report. The adjustments recommended by the agent have been approved by this office.

Your contention that in determining the amount of profit from the sale of real estate, the March 1, 1913 value of $750.00 per acre should be used, has been denied. It is held that the depreciated cost as at December 31, 1925 of $408.97 per acre is the correct basis to be used in determining the profit realized from the sale, in accordance with the provisions of section 204 of the Revenue Act of 1926.

Net income reported in the return	$ 62,415.99
Add:	
1. Profit on sale of real estate	146,529.28
2. Excessive depreciation	2,931.04
Net income as adjusted	$211,876.31

Explanation of Adjustments

1. Profit from the sale of real estate has been adjusted in accordance with the provisions of section 204 of the Revenue Act of 1926. The computations are as follows: [195]

Depreciated cost per acre as of December 31, 1925 is $408.97, including irrigation system and trees.

This value is the same as used in computing the adjusted profit in prior years.

Sale price		$303,641.35
Cost 138.387 acres at $408.97	$56,596.13	
Water stock	9,556.40	
Cost of moving old walnut trees	21,808.31	
Cost of trees removed	2,465.53	
Cost of right of way	510.00	
Tent house	843.44	
Total	$91,779.81	
Less:		
Depreciation for 1926 on 138.387 acres at $6.73	931.34	90,848.47
Profit realized		$212,792.88
Profit reported in return		66,263.60
Additional profit		$146,529.28

2. Depreciation has been adjusted in accordance with the provisions of section 214(a)(8) of the Revenue Act of 1926. The computations are as follows:

Depreciation adjustment on trees that had been sold up to January 1, 1927, on 512.0292 acres of the 1,000 acre tract and in 1927 there were sold 138.387 acres leaving a balance of unsold acreage of 349.584 acres.

349.584 acres trees at $35.60 per acre	$12,445.19
Value of above trees, $12,445.19 at 3%	$ 373.36
New trees, $128,362.59 at 3%	3,850.88
Depreciation allowable	$ 4,224.24
Depreciation claimed in return	7,155.28
Excessive depreciation restored to income	$ 2,931.04

[196]

Computation of Tax

Net income as adjusted	$211,876.31
Tax at 13½%	28,603.30
Previously assessed	8,426.16
Deficiency	$ 20,177.14

Since the issues involved are pending before the United States Board of Tax Appeals in connection with your tax liability for the years prior to 1927 and further consideration by this office would not result in any change in the findings set forth herein, this final notice under the provisions of section 274 of the Revenue Act of 1926 is issued without affording you opportunity for a conference.

A copy of this communication has been furnished your authorized representative, Mr. Claude I. Parker, Eighth Floor, Bank of America Building, Los Angeles, California.

EAE-2

[Endorsed]: United States Board of Tax Appeals. Filed at hearing, May 23, 1932.

A general denial was entered by the respondent as to the amended petition at the hearing on May 23, 1932. [197]

United States Board of Tax Appeals

Docket No. 52253

SAN JOAQUIN FRUIT & INVESTMENT COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby appeals from the determination of the Commissioner set forth in his deficiency letter dated December 6, 1930, bearing Symbols IT: AR: E-3-60D, JAH, and as the basis of its appeal sets forth the following:

(1) Petitioner is a corporation with principal place of business at Tustin, California.

(2) The deficiency letter, copy of which is attached, was dated December 6, 1930 and was presumably mailed on said date.

(3) The deficiency tax is income tax for the calendar year 1928 and is less than $10,000.00, to-wit, $3,061.39.

(4) The determination of tax contained in said deficiency letter is based on the following errors:

In determining the taxable income of petitioner for the year 1928 said income was overstated to the extent of at least $25,511.62 in that—

(a) The Commissioner found a taxable profit on real estate sold by petitioner of $37,997.04 based on an alleged cost to petitioner in 1916 of the property sold with subsequent adjustments to date of sale, whereas, petitioner alleges that a profit not in [198] excess of $14,637.84 should be determined, based either on the value as of March 1, 1913, or on the value as of the year 1916, when an option was exercised to purchase the property sold, so that the Commissioner overstated the petitioner's income with respect to taxable profit on real estate sold to the extent of at least $23,359.20, and

(b) The Commissioner computed depreciation on trees owned by petitioner in an amount of $4,202.86 based on their alleged cost in the year 1916 and subsequent thereto whereas, petitioner alleges that depreciation should have been computed in the amount of at least $6,355.28 based either on the March 1, 1913 value of said trees plus cost of trees subsequently planted, or on their value when an option to purchase was exercised in the year 1916, plus cost of trees subsequently planted so that the Commissioner overstated petitioner's income with respect to depreciation allowance on trees to the extent of at least $2,152.42.

(5) The facts relied on as the basis of this appeal are as follows:

(a) On October 5, 1906, this petitioner leased from the Irvine Company, One Thousand (1,000)

acres of land, agreeing to pay as rental therefor, one-fourth (¼) of the gross proceeds received annually from said property. Said agreement further contained an option to purchase the land referred to in ten (10) years for a stipulated sum of $200,000.00. The land was at once set out to walnut and citrus trees, and at the same time, a complete underground irrigation system was installed, together with electric lights, electric power, sewer system and so forth.

(b) On October 1, 1916, petitioner exercised its option to buy the land and during the period from November 17, 1916, to [199] October 29, 1918, it paid the sum of Two Hundred Thousand Dollars ($200,000.00) therefor, in accordance with the terms of the option agreement.

(c) During the year 1928 petitioner sold 20.019 acres of its citrus land and trees and in computing the taxable profit shown on its income tax return of $14,637.84 it used as a basis for determining said profit the March 1, 1913 value of the property sold with subsequent adjustments for depreciation etc. The Commissioner found a profit on the sale of $37,997.04 by using as a basis for determining such profit the amount paid by petitioner in 1916 under the terms of the option agreement hereinbefore mentioned instead of the March 1, 1913 value of the property sold or its value when acquired under the option above mentioned.

(d) In the preparation of its income tax return for the year 1928 petitioner claimed a deduction of $6,355.28 on account of depreciation sustained on

trees based on the March 1, 1913 value of said trees. The Commissioner disallowed the depreciation so deducted and substituted therefor $4,202.86, based on the alleged cost of the trees to the petitioner in the year 1916, when it acquired the property through exercise of the option agreement. The petitioner now alleges that it is entitled to a depreciation on account of trees for the year 1928 in the amount of at least—$6,355.28 and that the Commissioner understated the allowable depreciation to which the petitioner is entitled on trees to the extent of $2,152.42.

(e) While it is admitted that this petitioner did not have legal title to the land and trees on March 1, 1913, and that it was operating the property under a lease from the Irvine Company, nevertheless, it is alleged that at the time the lease was entered [200] into it was the understanding of all the parties concerned that the option to purchase embodied in the lease would be exercised, and it was because of this fact that the petitioner immediately began to develop the raw land by planting the same to citrus and walnut trees, and installing the irrigation system and other improvements above mentioned.

(f) By March 1, 1913, the trees planted had reached an approximate age of seven (7) years and were conservatively valued, exclusive of the land, at $1,115.00 per acre. When the petitioner's returns for years prior to 1922 were examined, the Revenue Agent who made the examination agreed that a value of $1,115.00 per acre for the trees alone was conservative, and it is alleged that by reason of

the fact that the land and trees combined were worth approximately $1,865.00 per acre on March 1, 1913, it was clearly indicated that the petitioner intended to exercise its option to buy the land in accordance with the terms of the option agreement, in order to secure the legal title to the property.

(g) It is further alleged that the terms and conditions under which said property was leased were entirely different from a lease of real property upon which annual crops are planted and grown, since in the latter case the value of the property is not being increased by reason of the growing of annual crops beyond the natural appreciation in value which may take place on account of the increase in population, etc., while in the case of the 1,000 acres leased by this corporation from the Irvine Company, this corporation was required under the terms of the lease to plant the land to citrus and walnut trees, which fact caused the value of the real property to increase anywhere from five to ten times. [201]

(h) By reason of the foregoing facts, it is alleged that it could very well be held that the terms and conditions under which the petitioner acquired title to the property were the same as if a contract to purchase the property had been entered into when the lease was first executed, and it had been provided that annual payments were to be made in amounts similar to those which were required to be paid as rentals under the terms of the lease with final payment to be made at the termination of the ten year period, and this was in effect what was

done. In the meantime, the land was being intensively developed and this petitioner had all the rights and benefits of ownership, just the same as it would have had, had the legal title therein vested in the petitioner.

(i) If it had not been the intention of the company to exercise the option provided for and thus to acquire the legal title to the property, its officers would not have proceeded with the development of the property in such manner as to increase its value during the seven-year period from 1906 to 1913, from $200.00 per acre to a value of approximately $1,800.00 per acre.

(j) Based on the price at which similar improved property was being sold on March 1, 1913, it is alleged that the petitioner could have disposed of its interest in the property, consisting of option agreement to purchase for an amount equal to $1,800.00 per acre on March 1, 1913.

(k) This petitioner had a property right in the property on March 1, 1913 equivalent to $1,800.00 per acre, which property right consisted of the option to purchase the property as described in the lease entered into with the Irvine Company and said property right would have been fully protected under the law. [202]

(l) In the year 1916 this petitioner in effect exchanged its then valuable property right consisting of the option agreement covering the sale and purchase of the property, together with the $200,000.00 in cash, for the property itself and thereafter its property right was represented by the

land and trees rather than by the option to purchase, and it is alleged that it is justified in claiming that the basis for determining taxable profits realized on the sale of the property would be the value of the property in 1916, rather than on March 1, 1913, for the reason that the property was acquired through an exchange in the manner set out above, which under the Revenue Act of 1916, would have been regarded as a closed transaction.

(m) In further support of its contention that it is entitled to use at least the March 1, 1913 value of the land and trees as the basis for determining taxable profit on the subsequent sale thereof and the allowable depreciation to be deducted from its gross income, the petitioner cites the Solicitor's Opinion #1110, Bulletin 1-2-705, wherein it was held that an individual who had filed on a placer mining claim prior to 1913, but who had not received patent to the land from the Government on said date, and in fact did not have his interest in said property recognized by the Government until 1920, was, nevertheless, entitled to a deduction on account of depletion sustained based on whatever value attached to the property on March 1, 1913.

(n) Reliance is also had on the decision rendered by the Board on the appeal of Arthur B. Groves, Docket No. 1159, Decision No. 1187, wherein agreement entered into between a partnership and the owners of certain property under the terms of which the partner- [203] ship was to sell the property, bearing all the expense of subdivision, etc., and out of the gross receipts was to pay the owners

of the property a fixed amount, was construed as an agreement or contract covering the sale of the property by the owner to the partnership, so that the partnership was entitled to consider that it had an interest in the property as of March 1, 1913, and to set up a value as of that date for the purpose of determining profit on the sale of said property.

(o) Reliance is also had on the decision of the Board of Tax Appeals in the case of Anna Taylor vs. Commissioner, 3 B. T. A. 1201 wherein it was held that a retained royalty right in an oil lease is property to which a value as of March 1, 1913 could be assigned.

(p) Reliance is also had on the decision of the Board of Tax Appeals on the Appeal of B. Kirk Rankin vs. Commissioner, 17 B. T. A. 1301. In said decision the Board held that a lessee of real property with option to purchase should not be permitted to compute depreciation deduction on the basis of the lease period but on the life of the depreciable assets and among other things said:

> "It is hardly probable that a man would expend the amounts here expended—particularly when we consider their comparison with the agreed value of the property at date of the execution of the original agreement—unless there was intended and assured to him more than a temporary occupancy of the building. In substance if not also in form the transaction is one wherein the occupancy began and continued with the purpose and assurance that occu-

pancy would be continued for an indefinite period of time."

WHEREFORE, this petitioner prays that this Board may hear its petition and find that the deficiency in tax proposed by [204] the Commissioner should not be asserted.

SAN JOAQUIN FRUIT &
INVESTMENT COMPANY,
By C. E. UTT, Pres.

State of California
County of Los Angeles—ss.

C. E. Utt of the City of Tustin, State and County aforesaid being first duly sworn deposes and says that he is President of the San Joaquin Fruit and Investment Company, a corporation with principal place of business at Tustin, California, and that said corporation is the petitioner referred to in the foregoing petition and that he has read the said petition or has had the same read to him and is familiar with the statements therein contained and that the facts therein stated are true and correct, except such facts as are stated to be on information and belief and those facts he believes to be true.

C. E. UTT

Subscribed and sworn to before me this 21st day of Jan., 1931.

[Seal] MARGUERITE LESAGE.
Notary Public in and for the County of Los Angeles, State of California. [205]

IT:AR:E:3-60D NP-2-28
JAH Dec. 6, 1930

San Joaquin Fruit and Investment Company,
c/o Claude I. Parker,
8th Floor, Bank of America Building,
Los Angeles, California.

Sirs:

You are advised that the determination of your tax liability for the year(s) 1928 discloses a deficiency of $3,061.39 as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED,

interest will accumulate to the date of assessment of the deficiency.

Respectfully,
DAVID BURNET,
Commissioner.
By (Signed) J. C. Wilmer
Deputy Commissioner.

Enclosures:
Statement
Form 882
Form 870
meg-4 [206]

STATEMENT

IT:AR:E:3-60D
JAH
In re: San Joaquin Fruit and Investment Company,
c/o Claude I. Parker,
8th Floor, Bank of America Building,
Los Angeles, California.

Tax Liability

Year	Corrected Tax Liability	Tax Previously Assessed	Deficiency
1928	$11,477.70	$8,416.31	$3,061.39

Reference is made to the report of the internal revenue agent in charge, Los Angeles, California, and to your protest submitted under date of June 21, 1930.

Careful consideration has been accorded your protest in connection with the agent's findings and the report on the conference.

The adjustments recommended by the agent have been approved by this office and since the only issues involved are now before the United States Board of Tax Appeals for prior years, this final notice of deficiency is being issued without affording you an opportunity to discuss your case with this office.

Net Income

Net income reported on return		$70,135.88
Add:		
1. Additional profit from sale of real estate	$23,359.20	
2. Excessive depreciation claimed	2,152.42	25,511.62
Net income as adjusted		$95,647.50

Explanation of Adjustments

1. This amount represents profit from the sale of real estate not previously shown as income, computed as follows:

20.019 acres sold for	$52,500.00
Less: Commissions and title expense	3,112.05
Net sale price	$49,387.95

[207]

Brought forward		$ 49,387.95
Cost:		
20.019 acres @ $316.03	$6,326.60	
Water stock assessments	1,365.20	
Cost of removing old walnut trees and planting orange trees	3,699.11	11,390.91
Taxable profit as corrected		$37,997.04
Taxable profit as reported		14,637.84
Additional profit		$23,359.20

Cost per acre is computed as follows:

Depreciated cost January 1, 1922 of 1,000 acres to be sold per revenue agent's report on San Joaquin Fruit Company dated October 5, 1922 covering year 1922		$380,174.54
Depreciated cost per acre 1/1/1922		380.17
Deduct:		
Depreciation on trees 1922-1927, inclusive, 3% a year or 18% of $35.60 (Total cost per acre)—	$6.41	
Depreciation 1922 to 1927, inclusive, on irrigation system, Power Plant and Buildings included in acreage cost at a total of $192,456.14 or $192,456.00 per acre 6 times 5 or 30% of $192,456.00	57.73	$ 64.14
Depreciation cost per acre 1/1/1928		$316.03

Article 51, Regulations 74.

2. This amount represents excessive depreciation claimed on trees computed as follows:

Balance of original 1,000 acres unsold December 31, 1927 per schedule C of revenue agent's report dated September 14, 1929 covering the year 1927	349.584-A [208]
Brought forward	349.584-A
Sold in 1928	20.019-A
Balance unsold—subject to depreciation in 1928	329.565-A
Cost of trees—329.565-A @ $35.60 per acre	11,732.51
Depreciation allowable—3% of $11,732.51	$ 351.98
Depreciation allowable on new trees 3% of $128,362.58	$ 3,850.88
Total depreciation allowable on trees	$ 4,202.86
Depreciation claimed	6,355.28
Excessive depreciation	$ 2,152.42

Depreciation has been computed in accordance with section 23(k) of the Revenue Act of 1928.

Computation of Tax

Net income	$95,647.50
Less:	
Exemption	none
Amount taxable at 12%	$95,647.50
Tax at 12%	11,477.70
Tax previously assessed	8,416.31
Deficiency	$ 3,061.39

meg-4

[Endorsed]: United States Board of Tax Appeals. Filed Jan. 26, 1931. [209]

[Title of Court and Cause—Docket No. 52253.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

(1) Admits the allegations contained in paragraph (1) of the petition.

(2) Admits the deficiency letter, copy of which is attached to the petition, was mailed December 6, 1930.

(3) Admits the deficiency tax is Federal income tax for the calendar year 1928, but denies that the amount is correctly stated in paragraph (3) of the petition.

(4) Denies that the respondent erred in the determination of the deficiency as alleged in paragraph (4) of the petition.

(5) Denies any knowledge or information sufficient to form a belief as to the truth of the allegations of paragraph (5), and subparagraphs, of the petition and, therefore, denies the same.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that petitioner's appeal be denied.

(Signed) C. M. CHAREST
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
C. A. RAY,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: United States Board of Tax Appeals. Filed Feb. 13, 1931. [210]

[Title of Court and Cause—Docket No. 52253.]

AMENDED PETITION

The above named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue set forth in his deficiency letter dated December 6, 1930, bearing the symbols IT:AR:E-3-JAH-60D, and as the basis for its appeal sets forth the following:

1. The petitioner is a corporation with principal place of business at Tustin, California.

2. The deficiency letter, copy of which is attached, was mailed to the petitioner on December 6, 1930.

3. The taxes in controversy are income taxes for the calendar year 1928, and in the amount of approximately $3,061.39.

4. The determination of tax contained in said deficiency letter is based on the following errors, to-wit:

(a) The respondent erred in failing and refusing to determine depreciation for the year 1928 on walnut and citrus trees owned by the petitioner on the basis of their value at the time of acquisition on December 26, 1922.

(b) In the alternative, the respondent erred in failing [211] and refusing to determine depreciation for the year 1928 on walnut and citrus trees owned by the petitioner on the basis of their value on November 30, 1916.

(c) In the alternative, the respondent erred in failing and refusing to determine depreciation for the year 1928 on value of the interest of petitioner in walnut and citrus trees on March 1, 1913.

(d) The respondent erred in failing and refusing to allow as the basis for the sale of 20.019 acres of land by the petitioner during the taxable year 1928, the value of such land at the time of acquisition on December 26, 1922.

(e) In the alternative, the respondent erred in failing and refusing to allow as the basis the value

of such land on November 30, 1916, when acquired by the San Joaquin Fruit Company upon exercise of an option.

(f) In the alternative, the respondent erred in failing and refusing to allow as the basis the value of such land on March 1, 1913, at which time the San Joaquin Fruit Company had an option to purchase said land.

5. The facts relied on as the basis of this appeal are as follows:

(a) The San Joaquin Fruit & Investment Co. was organized on July 12, 1922, and on November 8, 1922, issued all its authorized capital stock in exchange for all of the capital stock of the San Joaquin Fruit Company, a corporation, which had been organized on or about October 5, 1906. On December 26, 1922, the San Joaquin Fruit Company was formally dissolved by order of the Superior Court of Orange County, State of California, and on December 26, 1922, all [212] the assets of the San Joaquin Fruit Company were transferred to the San Joaquin Fruit & Investment Co.

(b) Among the assets acquired by the petitioner from the San Joaquin Fruit Company on December 26, 1922, were 600 acres of orchard land, with a total fair market value of $1,200,000.

(c) The fair market value of the trees on said lands on December 26, 1922, was at least $600,000, and their average prospective life was 18 years.

(d) The San Joaquin Fruit Company was organized on or about October 5, 1906, and acquired from the Irvine Co. (referred to hereinafter as the

Lessor), a lease on 1,000 acres of unimproved land situated in Orange County, California, for a period of 10 years, beginning December 1, 1906 and ending November 30, 1916.

(e) Said lease provided for an annual rental during the period of the lease of ¼th share of all crops, nuts and fruits grown or produced upon said land. Said agreement further contained an option to the San Joaquin Fruit Company to purchase any part or all of the leased lands on the last day of the lease at $200 per acre, payable one-fourth cash on the exercise of the option and the balance in two equal installments within three and five years respectively after date of purchase, the deferred payments to bear interest at 6 per cent per annum.

(f) The San Joaquin Fruit Co. set out said 1,000 acres of land to walnut and citrus trees and at the same time installed a complete underground irrigation system, together with electric lights, electric power, sewer system, buildings, and similar improvements. [213]

(g) On March 1, 1913, the 1,000 acres of land with the trees planted thereon, were worth at least $1,900,000, and the option owned by the San Joaquin Fruit Co. was worth, on March 1, 1913, at least $1,850,000.

(h) On November 30, 1916, the San Joaquin Fruit Co. exercised its option to purchase the 1,000 acres of land and the first payment of $75,000 provided by the contract, was made. The second and final payments of $50,000 and $75,000 were made on

December 31, 1917, and October 28, 1918, respectively.

(i) On November 30, 1916, the fair market value of the land and orchards thus acquired by the San Joaquin Fruit Co. was at least $2,200,000.

(j) The fair market value of the trees on said lands on November 30, 1916, was at least $1,500,000, and their average prospective life at that date, was 24 years.

(k) The fair market value of the trees on March 1, 1913, was at least $1,115,000, and their prospective life on that date was 27 years.

(l) On its returns for the taxable year 1928 the petitioner claimed depreciation on $2,504.40, based on the fair market value of said trees on March 1, 1913.

(m) The respondent has allowed depreciation on said trees based only upon their actual cost before setting in the ground, at the rate of 3 per cent, or a total depreciation on account of said trees of $351.98 for the taxable year 1928.

(n) The depreciation actually sustained and deductible on said trees during the year 1928 was in excess of $2,504.40. [214]

(o) During the taxable year 1928 the petitioner sold 20.019 acres of land for a net consideration of $49,387.85, upon which it reported a profit of $14,637.84. The respondent has allowed as the cost of said 20.019 acres of land, together with irrigation system and cost of removing old walnut trees and planting orange trees, the total amount of $11,390.91,

thereby increasing the profit by $23,359.20 to a total profit of $37,997.04.

(p) The basis of said 20.019 acres of land to the petitioner was at least $49,387.95, and no taxable profit was realized upon the sale thereof during the taxable year 1928.

WHEREFORE, the petitioner prays that this Board may hear the proceeding and hold that no deficiency is due by the petitioner for the taxable year 1928, and that the petitioner is entitled to a refund of $8,416.31 for the taxable year 1928.

GEORGE M. NAUS,
155 Montgomery Street,
San Francisco, California,
N. L. McLAREN,
444 California Street,
San Francisco, California,
JOSEPH D. PEELER,
c/o Miller, Chevalier, Peeler & Wilson,
819 Title Insurance Building,
Los Angeles, California. [215]
J. ROBERT SHERROD,
c/o Miller & Chevalier,
922 Southern Building,
Washington, D. C.
Counsel for Petitioner.

State of California,
County of Los Angeles.—ss.

C. E. Utt, being duly sworn, says that he is President of the San Joaquin Fruit & Investment Co.,

the petitioner above named; that he has read the foregoing petition and that the facts stated are true.

C. E. UTT

Subscribed and sworn to before me this 23 day of May, 1932.

[Seal] MILDRED K. ROGERS,
Notary Public in and for the County of Los Angeles, State of California. [216]

NP-2-28

IT:AR:E:3-60D
JAH December 6, 1930

San Joaquin Fruit and Investment Company,
c/o Claude I. Parker,
8th Floor Bank of America Building,
Los Angeles, California.

Sirs:

You are advised that the determination of your tax liability for the year 1928 discloses a deficiency of $3,061.39 as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition to the United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the enclosed agreement form and forward it to the Com-

missioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; WHEREAS IF NO AGREEMENT IS FILED, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
Commissioner.
By (Signed) J. C. WILMER
Deputy Commissioner.

Enclosures:
Statement
Form 882
Form 870. [217]

meg-4

STATEMENT

IT:AR:E:3-60D
JAH

In re: San Joaquin Fruit and Investment Company,
c/o Claude I. Parker,
8th Floor Bank of America Building,
Los Angeles, California.

Tax Liability

Year	Corrected Tax Liability	Tax Previously Assessed	Deficiency
1928	$11,477.70	$8,416.31	$3,061.39

Reference is made to the report of the internal revenue agent in charge, Los Angeles, California, and to your protest submitted under date of June 21, 1930.

Careful consideration has been accorded your protest in connection with the agent's findings and the report on the conference.

The adjustments recommended by the agent have been approved by this office and since the only issues involved are now before the United States Board of Tax Appeals for prior years, this final notice of deficiency is being issued without affording you an opportunity to discuss your case with this office.

Net Income

Net income reported on return		$70,135.88
Add:		
1. Additional profit from sale of real estate	$23,359.20	
2. Excessive depreciation claimed	2,152.42	25,511.62
Net income as adjusted		$95,647.50

Explanation of Adjustments

1. This amount represents profit from the sale of real estate not previously shown as income, computed as follows:

20.019 acres sold for		$52,500.00
Less: Commissions and title expense		3,112.05
Net sale price		$49,387.95
		[218]
Brought Forward		$49,387.95
Cost:		
20.019 acres @ $316.03	$6,326.60	
Water stock assessments	1,365.20	
Cost of removing old walnut trees and planting orange trees	3,699.11	11,390.91
Taxable profit as corrected		$37,997.04
Taxable profit as reported		14,637.84
Additional profit		$23,359.20

Cost per acre is computed as follows:

Depreciated cost January 1, 1922 of 1,000 acres to be sold per revenue agent's report on San Joaquin Fruit Company dated October 5, 1922 covering year 1922		$380,174.54
Depreciated cost per acre 1/1/1922		380.17
Deduct:		
Depreciation on trees 1922-1927, inclusive, @ 3% a year or 18% of $35.60 (Total cost per acre)	6.41	
Depreciation 1922 to 1927, inclusive, on Irrigation System, Power Plant and Buildings included in acreage cost at a total of $192,456.14 or $192,456.00 per acre		
6 times 5 or 30% of $192,456.00	57.73	64.14

Depreciation cost per acre 1/1/1928 Article 51, Regulations 74.	$ 316.03

2. This amount represents excessive depreciation claimed on trees computed as follows:

Balance of original 1,000 acres unsold December 31, 1927 per Schedule C of revenue agent's report dated September 14, 1929 covering the year 1927	349.584-A
	[219]
Brought Forward	349.584-A
Sold in 1928	20.019-A
Balance unsold—subject to depreciation in 1928	329.565-A
Cost of trees—329.565-A @ $35.60 per acre	11,732.51
Depreciation allowable—3% of $11,732.51	$ 351.98
Depreciation allowable on new trees 3% of $128,362.58	$ 3,850.88
Total depreciation allowable on trees	$ 4,202.86
Depreciation claimed	6,355.28
Excessive depreciation	$ 2,152.42

Depreciation has been computed in accordance with section 23(k) of the Revenue Act of 1928.

Computation of Tax

Net Income	$95,647.50
Less:	
Exemption	none
Amount taxable at 12%	$95,647.50
Tax at 12%	$11,477.70
Tax previously assessed	8,416.31
Deficiency	$ 3,061.39

[Endorsed]: United States Board of Tax Appeals. Filed at hearing, May 23, 1932.

A general denial was entered by the respondent as to the amended petition at the hearing on May 23, 1932. [220] meg-4

United States Board of Tax Appeals

SAN JOAQUIN FRUIT & INVESTMENT COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket Nos. 6989, 20801, 27038, 35835, 40407, 42726, 49317, 52253.

Promulgated June 15, 1933.

1. Where a deficiency notice is sent to a corporation and its transferee files a petition from the no-

tice, designating itself as the successor of the transferor corporation through change of name only, the Board has jurisdiction to hear the proceeding. Burnet v. San Joaquin Fruit & Investment Co., 52 Fed. (2d) 123, followed.

2. Where property is acquired after February 28, 1913, by a lessee through the exercise of an option in the lease to purchase the leased property, the basis to the purchaser for invested capital, determining gains or losses on sales, and computing exhaustion on the assets so acquired, is cost to him.

3. The petitioner acquired all of the stock of another corporation in exchange for all of its stock. On the same day steps were taken to liquidate and dissolve the other corporation. Within practically the shortest possible time allowed by law, the corporation transferred its assets to the petitioner in exchange for its stock and dissolved. Upon the consummation of these transactions in excess of 80 percent of petitioner's stock was held by the same persons who had held all of the stock of the dissolved corporation. Held that the transaction is within the reorganization provisions of the 1924, 1926 and 1928 Acts and the basis to the petitioner for gains and losses and exhaustion is cost to the transferor corporation.

Joseph D. Peeler, Esq., George M. Naus, Esq., and N. L. McLaren, C. P. A., for the petitioner.

J. R. Johnston, Esq., for the respondent.

OPINION.

SEAWELL: These proceedings were consolidated for hearing and report, and involve the rede-

termination of deficiencies in income and excess profits taxes for 1920 and 1921 in the respective amounts of $22,872.09 and $21,867.40; deficiencies of $58,422.79, $2,898.43, $10,965.80, $17,663.58, $20,177.14 and $3,061.39 in income taxes for 1922, 1924, 1925, 1926, 1927 and 1928, respectively; and the liability of the petitioner as a transferee for unpaid income and excess profits [221] taxes of the San Joaquin Fruit Co. for 1921 in the amount of $21,867.40.

At the threshold we are confronted with a motion of the respondent asking that we make the decision of the court in Burnet v. San Joaquin Fruit & Investment Co., 52 Fed. (2d) 123; reversing, in part, 16 B. T. A. 1290, the judgment of this Board as to Docket Nos. 6989 and 20801 for 1920 and 1921, and that his determination of petitioner's income tax liability be approved.

The facts necessary to a consideration of the motion, briefly stated, are as follows: A consolidated hearing was held in Los Angeles, California, May 3, 1927, on all of the issues raised in Docket No. 6988 for 1918 and 1919 (not now involved) and Docket Nos. 6989 and 20801, except the one involving special assessment, which was not tried because of the refusal of the Commissioner of Internal Revenue to answer a subpoena to produce comparatives. Upon the conclusion of the hearing, orders were entered continuing the proceedings to the reserve calendar pending a decision in the case of Blair v. Oesterlein Machine Co., 275 U. S. 220. Thereafter in 1928 amended and supplemental petitions were

filed in the proceedings in which, among other things, it was alleged that the petitioner was not organized until 1922 and therefore was not liable for the proposed deficiencies. The proceedings were consolidated and set for hearing on October 16, 1928, at which time the petitioner submitted evidence on the new issues raised in the amended petitions. The deficiency notices for 1918, 1919 and 1920 were mailed to the petitioner, and the notice for 1921 was addressed to the San Joaquin Fruit Co., hereinafter referred to as the "Fruit Co.", in care of the petitioner.

In a decision promulgated June 29, 1929 (16 B. T. A. 1290), the Board held that the petitioner was not organized until 1922 and, accordingly, was not liable for the deficiencies proposed against it for 1918, 1919 and 1920, and that, as the deficiency notice for 1921 was not mailed to the petitioner, the Board was without jurisdiction to hear the proceedings for that year. Appropriate orders were thereupon entered that there were no deficiencies for 1918, 1919 and 1920, and dismissing, for lack of jurisdiction, the proceedings in so far as they related to 1921.

The respondent took an appeal from the decision to the Circuit Court of Appeals for the Ninth Circuit. The court sustained the Board as to 1918 and 1919 and reversed its decision as to 1920 and 1921, the former ruling being in accordance with an admission made by counsel for the Government that the deficiencies were barred by the statute of limitations. On August 4, 1931, after the receipt of

the court's mandate affirming the Boards decisions as to 1918 and [222] 1919 and reversing it as to 1920 and 1921 and commanding "that such further proceedings he had in such cause as according to right and justice and the laws of the United States ought to be had," this Board, by appropriate order, placed Docket Nos. 6989 and 20801, applicable to the years 1920 and 1921, respectively, on the Day Calendar of October 5, 1931, for hearing on the merits. Thereafter the respondent consented to a motion of the petitioner for the transfer of the proceedings to the Circuit Calendar.

By motion filed October 13, 1931, the respondent alleged, among other things, that all of the issues involved in the proceedings for 1920 and 1921 had been tried on May 3, 1927, with the exception of the issue relating to special assessment, and asked that the Board set a time for the filing of briefs upon questions other than special assessment, and that after the issues were decided, to set the case down for hearing on the special assessment question. The petitioner opposed the motion. A hearing was had on the motion with the result that on January 9, 1932, an order was entered denying the respondent's motion to decide the issues involved other than special assessment on the then record and continuing the proceedings on the Circuit Calendar "for the presentation of such other and further evidence respecting the issues herein as the parties may be advised." In April 1932 the proceedings, and other cases involving identical issues raised by the petition for later years, were placed on the Circuit

Calendar for hearing. A consolidated hearing was held at Los Angeles, California, May 23-24, 1932, at which the respondent moved to make the aforesaid decision of the Circuit Court the Board's decision for 1920 and 1921. The presiding Member reserved judgment on the motion and proceeded to hear testimony on all of the issues raised in all of the petitions, except special assessment.

The underlying theory of the respondent's contention is that the decision of the Circuit Court of Appeals settled all of the issues raised by the petitioner in Docket Nos. 6989 and 20801 for the years 1920 and 1921, and for the Board to receive further evidence on the issues and render a decision thereon would amount to a review of the judgment of the appellate court.

The petitioner is not asking us to review the decision of the appellate court with the view of reaching a contrary conclusion. All it seeks to do is to have us decide questions raised on the merits in the light of all the evidence of record, issues it contends were not decided by this Board or the Circuit Court of Appeals.

The hearing had in Los Angeles in 1927 was not a full and complete one on the merits, and it appears from the record, as we pointed out in our order of January 9, 1932, that counsel for the petitioner contemplated the introduction of other and further evidence to support [223] its allegations. The hearing had in October 1928 was confined to the law questions raised by the amended petitions, and in the Board's report of the hearing, the find-

ings of fact, and decisions related only to such questions, the questions on the merits not being regarded as submitted for decision. In his appeal to the Circuit Court of Appeals from the Board's decision, the respondent alleged as error only the matters decided by the Board, alleging that such evidence as had been offered on the other questions was immaterial to a review of the decision.

An examination of the court's decision discloses that it did not discuss or decide questions other than those passed upon by the Board. After setting forth in full the Board's findings of fact and opinion, the court discussed the effect of petitioner's action before this Board and the sufficiency in law of the respondent's notice to the Fruit Co. as a notice to the petitioner, without mentioning questions raised on the merits.

The court's reversal of our decision did not directly or indirectly settle the questions now before us; hence it made no rulings which may be regarded as controlling the questions on the merits. As to them, the petitioner has not had its day in court and is entitled to a decision from the Board. Accordingly, the respondent's motion is denied.

The petitioner questions our jurisdiction to hear the proceedings in so far as they relate to 1922 on the ground that it has received no deficiency notice for that year.

On February 28, 1927, the respondent mailed a deficiency notice to the Fruit Co., informing it of a deficiency of $58,422.79 in income taxes for 1922. Within the time allowed by law the petitioner filed

a petition with the Board, alleging several errors in the determination of the deficiency. The petition is captioned "San Joaquin Fruit & Investment Company, Successor to San Joaquin Fruit Company, through change of name only," and is signed "San Joaquin Fruit & Investment Company (formerly San Joaquin Fruit Company) By C. V. Newman, Secretary." In the verification of the petition it is stated that the San Joaquin Fruit & Investment Co. succeeded the San Joaquin Fruit Co. "through change of name only during the year 1922 and is the petitioner referred to in the foregoing petition."

We had the identical question before us in San Joaquin Fruit & Investment Co., supra, for the year 1921, and from facts in all material respects the same as those here we found that the deficiency notice was not a notice to the petitioner, and held that we lacked jurisdiction to hear and decide the proceeding. On appeal, the Board was reversed. Burnet v. San Joaquin Fruit & Investment Co., supra. We [224] feel bound by the court's decision for the prior year in view of the right of appeal to the same court from our decision for the taxable year. Accordingly, we hold that we have jurisdiction to hear and decide the issues raised for the year 1922.

The issues on the merits presented for decision are (a) the proper basis for determining the amount of gain realized or loss sustained on the sale of certain land in each of the years 1922 to 1928, inclusive, and the computation of depreciation on walnut and orange trees in all of the taxable years; (b)

whether invested capital should be increased for the years 1920 and 1921; and (c) whether a loss of $14,272 was sustained in 1926 on account of the removal of certain walnut trees from petitioner's land. The special assessment issue applicable to 1920 and 1921 was abandoned.

In 1906 C. E. Utt and Sherman Stevens negotiated a certain lease from the Irvine Co. for 1,000 acres of bare and unirrigated land in Orange County, California, the acreage being part of a 100,000-acre tract of land owned by the lessor. Subsequently in 1906 the Fruit Co. was organized under the laws of California with a capital of $100,000 divided into 1,000 shares, each of the par value of $100, for the purpose of executing the lease. The Irvine Co., a West Virginia corporation, C. E. Utt and Sherman Stevens each purchased at par 270 shares of tl stock. No additional stock was ever issued. All of the stock of the Irvine Co., except qualifying shares, was owned by James Irvine.

On October 13, 1906, the Irvine Co. leased the land to the Fruit Co. for a term of ten years beginning December 1, 1906. By the terms of the lease the lessee was required among other things, to plant all of the land to fruit trees within four years at its own expense; to grow crops of grain, beans and other products on such other portions of the land as could be cultivated without material injury to the fruit trees; and to sink wells for and develop sufficient water on a designated tract of nearby land owned by the lessor for use in producing crops on the leased land. The lessor was to re-

ceive as rent for the land one fourth of the crops produced by the lessee on the leased premises. The lessee was given an option to purchase not in excess of 500 acres of the land before the expiration date of the lease at $200 per acre cash, and all of the tract at the expiration of the lease at the same price, payable one fourth cash and the balance within five years. An exercise of the right to purchase portions of the tract during the life of the lease worked a termination of the option to purchase all of the tract on the expiration of the term of the lease. The lessee could not assign or transfer the lease, or sublet any portion of the land, without the written consent of the lessor. [225]

Within two years the lessee developed the amount of water required by the lease for irrigation purposes and by the close of 1910 expended from $150,000 to $170,000 in developing and improving the tract.

On November 30, 1916, the Fruit Co. exercised the option given in the lease to purchase the property.

In 1907 the lessee planted 140 acres of the tract to orange trees and 500 acres to walnut trees. In 1909 it increased the acreage of orange trees to 390 and walnut trees to 600.

The San Joaquin Fruit & Investment Co., the petitioner, was organized in July 1922, under the laws of California, with a capital stock of $1,500,000 divided into 15,000 shares, each of the par value of $100. The stockholdings of C. E. Utt, Sherman Stevens and the Irvine Co. in the Fruit Co., amount-

ing to 810 shares, were surrendered November 6, 1922. The surrendered stock was immediately reissued, the petitioner receiving 807 shares, and C. E. Utt, Sherman Stevens and James Irvine, Jr., one qualifying share each. On the same day the petitioner issued shares of its stock as follows in exchange for the stock it had received of the Fruit Co.:

	Shares
Irvine Co.	4,998
James Irvine	1
James Irvine, Jr.	1
Sherman Stevens	5,000
C. E. Utt	2,500
Margaret R. Utt	2,500

No new capital was put into the petitioner at the time of the issuance of its stock.

The directors of the Fruit Co. on November 6, 1922, called a meeting of the corporation's stockholders for November 18, 1922, for the purpose of considering the question of dissolving the corporation. The meeting was held on the called date, at which the stockholders adopted a resolution to liquidate and dissolve the corporation. On November 21, 1922, the directors of the Fruit Co. filed a petition with the Supreme Court of the County of Orange, State of California, for the dissolution of the corporation. On the same day the court ordered the filing of the application and the advertising thereof for a period of 30 days, and set the proceeding down for further hearing on December 2[illegible],

1922. At some undisclosed time between the filing of the petition and December 26, 1922, C. E. Utt, Sherman Stevens and James Irvine, Jr., assigned their stockholdings in the Fruit Co. to the petitioner. On December 26, 1922, said court found the petitioner to be the sole stockholder of the Fruit Co. and ordered all of the latter's assets to be transferred to the former. The Fruit Co. was dissolved December 26, 1922. At or about that time the petitioner surrendered the stock of the Fruit Co. and received therefor all of the corporation's assets. [226]

The physical assets of the Fruit Co. were taken up on the books of the petitioner at the value of $1,206,000 in round figures in accordance with an appraisal made of the properties as of November 15, 1922.

In determining the deficiencies the respondent computed depreciation on orange and walnut trees and determined gains realized from sales of acreage each year, commencing in 1922, on the basis of the actual cost of the assets to the Fruit Co. The petitioner argues as to the years 1920, 1921 and 1922, that the exercise of the option to purchase in 1916 operated to convert capital assets, consisting of a vested property right, a valuable option and purchase money, into a fee simple title, a taxable transaction, giving rise to a new basis, namely, the value of the land and trees on the date the option was exercised. In the alternative, it is claimed, among other things, that the Fruit Co. had an equitable interest in the assets prior to the exercise of the

option and for all practical purposes was the owner of the property during that period; that the instrument of October 13, 1906, should be construed as a sale of the land, and, one or more of these things being the case, the proper basis is the March 1, 1913 value of the land and improvements, or the value at that time of the option, plus $200,000, the price paid upon its exercise.

We will first consider the character of the agreement of October 13, 1906. The execution of the agreement of October 13, 1906, was preceded by negotiations between Utt and Stevens, experienced orchardists, and the Irvine Co., represented by James Irvine, its principal stockholder, for a purchase by the former of 1,000 acres of the 100,000-acre ranch owned by the Irvine Co. Irvine preferred to sell the land outright, but had grave doubt as to the ability of Utt and Stevens to finance the purchase on their limited capital of about $30,000 each, particularly in view of the absolute necessity of making a large capital outlay at once for water for irrigation purposes. A lease of the desired land was suggested by the owner, but Utt and Stevens expressed unwillingness to enter into the venture unless it would involve more than a lease. Irvine then endeavored to persuade Utt and Stevens to take a smaller tract of land, but without avail. All of them were confident that the proposed operations would be a success, provided water could be found nearby in sufficient quantities, and while they were confident that water could be developed, the quantity obtainable was then unknown. Further negotiations

resulted in an agreement on the part of the owner to involve 1,000 acres in the deal and to join Utt and Stevens in the venture on an equal basis to increase the chances of success. The Fruit Co. was then formed to execute and carry out the contract. [227]

The instrument in question was drafted by Irvine. It is denominated a lease, and throughout refers to the owner as the "lessor" and the Fruit Co. as the "lessee." It provides that the "Lessor hereby leases to the said Lessee"; and makes provisions for the retention of title to the land by the lessor until the completion of the installment payments to be made in case the option granted to purchase was exercised; the payment of taxes and assignments on the land by the lessor "until said lands have been sold to the said lessee, or its assigns, as herein agreed"; and for the retention by the lessor of one fourth of the crops produced "as rent" for the property. No provision was made in the instrument for the application of rent money to the purchase price of the property in case the option was exercised, a condition that existed in the document involved in Robert A. Taft, 27 B. T. A. (Feb. 27, 1933), and the facts are by no means parallel to those in Arthur B. Grover, 3 B. T. A. 508. The instrument itself is opposed to the idea of a sale.

The testimony offered does not prove that the intention of the parties to the instrument was to make a sale of the land. Negotiations were commenced by Utt and Stevens with the express pur-

pose of buying the land, but their offers to buy were declined for reasons already given. They took the next best thing obtainable from their standpoint, namely, a lease with an option to buy portions of the land for cash during the term of the lease or all of it upon its termination, on terms. Irvine testified for the petitioner on direct examination that he "could not have sold it to them in any other way; they could not have bought it * * *, they did not have the financial means to buy it; impossible." Other testimony of his shows that the Irvine Co. executed a great many other instruments along the same line. Other witnesses testified that failure to exercise the options granted in such instruments was the rule rather than the exception.

We have no doubt that at the time the agreement was entered into the Fruit Co. believed the venture would be sufficiently successful to justify the exercise of the option as to a portion or all of the tract, but much more is required to show an intention to buy and sell under a particular instrument. Profit was the evident object of the transaction, and had the venture been unsuccessful the lessees would probably have permitted the option to lapse with the expiration of the lease. We construe the document to be a lease, with option to purchase, as it purports to be, and not a contract of sale, and will proceed to decide the issues accordingly.

There is testimony in the record that the option was a valuable property right in the hands of the Fruit Co. and that the land in [228] question had

a value in November 1916, considerably in excess of the price paid for it. Had the acquisition of the land at that time not been through the exercise of an option to purchase, granted ten years before, there could be no question that the basis to the purchaser would be actual cost of the land. Does the fact that the property was under option for ten years prior to its purchase affect the situation? We think not.

The subject matter of the 1916 transaction was not the option, but the land itself. The option was merely the instrumentality through which the property was acquired. While the exercise of the right to purchase by the optionee might have resulted in taxable gain or deductible loss to the lessor, it was not a taxable transaction to the Fruit Co. As to it, there was a mere conversion of a right given to purchase into a contract of sale of the land (Smith v. Bangham, 156 Cal. 359; 104 Pac. 689), without resulting gain or loss.

The granting of the option to purchase was not a sale of the land; only a sale of the right to purchase the property. Smith v. Bangham, supra; Hicks v. Christeson, 174 Cal. 712; 164 Pac. 395; Menzel v. Primm, 6 Cal. App. 204; 91 Pac. 754. Under the great weight of authority, the Fruit Co., as optionee of the land, had no interest, legal or equitable, in the property. Richardson v. Hardwick, 106 U. S. 252; Todd v. Citizens' Gas Co. of Indianapolis, 46 Fed. (2d) 855; certiorari denied, 283 U. S. 852; Ludy v. Zumwalt, 85 Cal. App. 119; 259 Pac. 52. It

was not, therefore, until the exercise of the option that the Fruit Co. acquired an interest in the property. Such interest as it had in the land during 1920, 1921 and 1922 was acquired by reason of the conversion of the right of purchase into a contract of sale in 1916, at a cost of $200,000.

The case of People's Street Ry. Co. v. Spencer, 156 Pa. 85; 27 Atl. 113, is cited to show that the Fruit Co. should be regarded as the owner of the land from 1906 because of its exercise of the option. The reasoning of the court in that case was based upon the theory that the transaction giving rise to the suit was, in substance, a loan of money, whether the parties were lessor and lessee, vendor and purchaser, or mortgagor and mortgagee, not being considered important, and that the railway company had an equitable interest in the property at the time in question. When construed in the light of such conclusions, the decision lacks force as supporting a view that the optionee here should be considered as the owner ab initio. In this respect the case of Smith v. Bangham, supra, did not go further than to say that an optionee had such an interest in the optioned property as to "cut off intervening rights acquired with knowledge of the existence of the option." The cases of Crowley v. Byrne, [229] 71 Wash. 444; 129 Pac. 113, and Horgan v. Russell, 24 N. D. 490; 140 N. W. 99, are to the same general effect.

Whether the March 1, 1913, value of the land and trees, or the value at that time of the option, is

material would seem to turn upon the interest of the Fruit Co. in the property prior to 1916. As we have pointed out, the Fruit Co. had no property right in the land prior to the exercise of the option to purchase and, accordingly, no basis for exhaustion or computing gain or loss. The option expired with the exercise thereof and any value it might have had while in existence can not affect the cost basis of property acquired through it. Not having had any interest in the property prior to 1916, the values of the land and improvements, and the option at March 1, 1913, are, in our opinion, of no importance.

The petitioner claims that the exercise of rights to purchase stock is analogous to the situation here. While a stock right has some of the characterization of an option, it is "essentially analogous to a stock dividend." Miles v. Safe Deposit & Trust Co. of Baltimore, 259 U. S. 247. When stock acquired through the exercise of such rights is sold, the cost of the stock, not the value of the right when received, is the basis for computing gain or loss on the transaction. Ayer v. Blair, 25 Fed. (2d) 534.

For 1924 and subsequent taxable years the petitioner is asking that we allow depreciation on the assets and compute profit on sales of parcels of the tract based upon the fair market value of the property on December 26, 1922, when the petitioner is alleged to have received the assets in connection with the liquidation and dissolution of the Fruit Co. It contends that the exchange of stock of the Fruit Co. for its properties in dissolution proceedings

was a taxable transaction giving rise to a new basis for the assets acquired. The respondent maintains that the assets in question were not so acquired, but through a reorganization, and that the basis to the petitioner is cost to the transferor corporation.

Section 204 (a) (7) of the Revenue Act of 1924 provides that the basis for determining gain or loss from the sale of the property acquired after February 28, 1913, shall be the cost of such property, except that:

> If the property (other than stock or securities in a corporation a party to the reorganization) was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 80 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. [230]

Section 203 (h) and (i) of the same Act reads as follows:

> (h) As used in this section and sections 201 and 204—
>
> (1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority

of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(i) As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

The basis for allowance of exhaustion of assets under the statute is the same. Sec. 204 (c). The same numbered sections of the Revenue Act of 1926 and sections 112 (i) and (j), 113 (a) (7) and 114 (a) of the Revenue Act of 1928 are to the same effect.

Counsel for the petitioner admit there would be some merit to the respondent's position had there

been an exchange of petitioner's stock for property of the Fruit Co. instead of, as it says actually occurred, a surrender of the stock of the Fruit Co. for its assets in dissolution proceedings. We are asked, in effect, to ignore completely the circumstances under which the petitioner acquired the stock of the Fruit Co. and decide the issue without reference to such matters. We do not think the preliminary steps leading up to the acquisition of the Fruit Co.'s property should be ignored in deciding the question. Considered together they clearly show an intention to terminate the existence of the Fruit Co. in favor of the petitioner in the shortest possible time, without a substantial change in stock ownership.

The exchanges of stock by which the petitioner acquired all but three shares of the stock of the Fruit Co. and the old stockholders of that corporation received about 83 percent of the stock of the petitioner, together with the calling of a meeting of the stockholders of the Fruit Co. for November 18, 1922, to consider the matter of dissolving the Fruit Co., all occurred on November 6, 1922. Within three days after the stockholders acted to liquidate the affairs of the Fruit Co., application was made to the appropriate court for a dissolution decree. After advertisement as required by law and on a date set by the court at the first hearing, a further hearing was [231] had on the application. The hearing resulted in a decree of the court for the dissolution of the Fruit Co. and the transfer of all its assets to petitioner, its sole stockholder, the outstanding

qualifying shares having previously been transferred to it. Except for the period of about 12 days that could have been saved by obtaining waivers from the stockholders for the meeting held on November 18, 1922, the proceedings were carried out in practically the shortest possible time. When these steps had been completed, all within about one and one half months, the petitioner owned all of the property of the Fruit Co. and the original stockholders of the Fruit Co. held about 83 per cent of petitioner's stock. Under these circumstances, we conclude that the assets of the Fruit Co. were not acquired in liquidation proceedings, as contended by the petitioner, but in connection with a reorganization. See Mente & Co., 24 B. T. A. 401; Flushing Nurseries Co., 25 B. T. A. 938.

Immediately after the acquisition by the petitioner of the assets of the Fruit Co. for the latter's stock, the old stockholders of the transferor corporation were in control of petitioner, by reason of their ownership of more than 80 per cent of its stock. The transaction thus comes squarely within the reorganization provisions of the statute. Under the statutes the basis to the petitioner is the same as it would have been in the hands of the transferor had it retained the property, with adjustments for gain or loss recognized to the transferor in the exchange. No adjustments are required in these proceedings as no gain or loss was recognized to the transferor. Mente & Co., supra; Fred A. Hellebush et al., Trustees, 24 B. T. A. 660; W. P. Fox & Sons, Inc., 15 B. T. A. 115.

There appears to be no controversy as to the price paid for the land, or the cost of the trees. In any event, the petitioner has failed to show that the costs are different from those determined by the respondent and, accordingly, his determinations will not be disturbed.

For each of the taxable years exhaustion of the orange and walnut trees was claimed by the petitioner and allowed by the respondent on the basis of a useful life of 33 1/3 years. The testimony and documentary evidence offered on the question are conflicting. Two qualified witnesses of petitioner testified that orange trees have a productive life of from 30 to 40 years. One of these witnesses expressed the opinion that the productive life of walnut trees is from 30 to 40 years, and the other testified that their life is from 40 to 50 years. Other evidence, consisting of reports prepared by the University of California on production costs of oranges and walnuts in Orange County, California, is that orange and walnut trees have a life for exhaustion purposes of 45 to 60 years, respectively. On the showing made, we do not think the rate used by the respondent is un- [232] reasonable. Except for adjustments that may be necessary on account of the proof made of the acreage planted to trees in the taxable years, the respondent's allowances will not be disturbed.

The petitioner contends that if the exercise of the option is held to be a taxable transaction, the invested capital of the Fruit Co. for 1920 and 1921 should be increased by the difference between the

November 30, 1916, value of the tract and the purchase price of $200,000, as earned surplus. The respondent made an allowance for invested capital based upon the cost of the land and improvements made thereon by the Fruit Co.

The exercise of the option was not, as we have pointed out, a taxable transaction of the petitioner, but merely resulted in a conversion of the option to purchase into a contract of sale of the property. The assets were acquired solely for cash. Property acquired under such circumstances may not be included in invested capital at a figure in excess of cost. Steele Wedeles Co. v. Commissioner, 63 Fed. (2d) 541; affirming 11 B. T. A. 279; H. T. Cushman Mfg. Co., 2 B. T. A. 39; Klamer-Goebel Furniture Co., 11 B. T. A. 1322; Jamison Coal & Coke Co., 24 B. T. A. 554. On this issue the respondent is sustained.

In its return for 1926 the petitioner claimed a loss deduction of $14,272 on account of the removal of walnut trees from 20 acres of its land. The respondent seems to have reduced the petitioner's basis for the loss from March 1, 1913, value to cost in 1916, resulting in a disallowance of $13,834.17 of the amount claimed.

The issue is not briefed by the respondent and in the briefs filed on behalf of the petitioner it is said that the "controversy turns on the proper basis of the orchard." If that be the only question for decision the respondent must be sustained, as the basis for determining the amount of the deduction

for losses on property acquired after February 28, 1913, as this was, is cost. Sec. 234 (a) (4), Revenue Act of 1926.

The respondent would nevertheless prevail on the evidence offered by the petitioner to support the deduction. The allegation of loss made in the petition was denied by the respondent in his answer. Such evidence as we have on the question consists of testimony of Irvine and Utt. The former testified that some walnut trees were removed in 1926 or 1927 to plant the land to orange trees. The testimony of Utt, who has been president of petitioner since its organization and, as such, actively engaged in the conduct of its affairs, is that walnut trees were removed during a period of three or four years, and that he had no recollection of the removal of any of them in 1926. Manifestly this testimony is insufficient to support a finding that the trees were removed in 1926 or that a loss in the amount [233] claimed was sustained in that year. On this issue the respondent is sustained.

There remains for disposition the transferee liability of petitioner for income and excess profits taxes of the Fruit Co. for 1921 in the amount of $21,867.10. The transferee notice was mailed December 29, 1927, more than a year after the mailing of the deficiency notice to the Fruit Co., but before the petitioner amended its petition for 1921 as a taxpayer so as to raise the jurisdictional question. The outcome of the jurisdictional question was, as we have already pointed out, favorable to the

petitioner before this Board, but unfavorable on appeal to the Circuit Court of Appeals for the Ninth Circuit.

The petitioner is not liable both as a taxpayer and a transferee for the same taxes, and the statute does not contemplate collection of taxes twice. In view of the anomalous condition in which we find the record, Docket No. 35835 will be placed on the Reserve Calendar, subject to restoration to the General Calendar for further proceedings on 30 days' notice by either party or the Board's own motion.

Reviewed by the Board.

Decision will be entered under Rule 50, except in Docket No. 35835.

MURDOCK, concurring: I agree that this case presents the identical question which was before us in San Joaquin Fruit & Investment Co., 16 B. T. A. 1290, on which we were reversed in Burnet v. San Joaquin Fruit & Investment Co., 52 Fed. (2d) 123. With all due respect to the Circuit Court of Appeals which reversed the Board, I still believe that the Board correctly decided that case. However, it was reversed, and this case would go to the same Circuit. But the prevailing opinion is misleading in the emphasis placed upon the statements contained in the pleadings that the Investment Co. was successor to the Fruit Co. through change of name only. The facts clearly appear in this case

as they did in the other case and the change was not a change of name only. Two different corporations were in existence at the same time.

VAN FOSSAN agrees with the above. [234]

United States Board of Tax Appeals
Washington

Docket No. 6989. Docket No. 20801. Docket No. 27038. Docket No. 40407. Docket No. 42726. Docket No. 49317. Docket No. 52253.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the opinion of the Board promulgated June 15, 1933, the respondent herein on July 12, 1933, having filed a notice of settlement and proposed redetermination of tax, and the petitioner on July 27, 1933, having filed an acquiescence in the proposed redetermination, it is

ORDERED AND DECIDED: That there are deficiencies as follows:

1920	$22,872.09
1921	21,867.40
1922	58,422.79
1924	2,898.43
1925	10,965.80
1926	17,663.58
1927	20,177.14
1928	3,061.39

[Seal] (s) ANNABEL MATTHEWS,
Member.

Entered: July 31, 1933. [235]

[Title of Court and Cause—Consolidated Cases.]

PETITION FOR REVIEW

To the Honorable the Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

The petitioner above named, in pursuance of the provisions of Section 1001 of the Revenue Act of 1926, as amended by Section 1101 of the Revenue Act of 1932, hereby petitions this Honorable Court to review the decision of the United States Board of Tax Appeals, promulgated June 15, 1933, final order determining deficiencies entered on July 31, 1933, approving deficiencies in Federal income and/or profits taxes for the calendar years 1920 to 1928, inclusive, in the following amounts: [236]

Docket No.	Year	Alleged Deficiency
6989	1920	$22,872.09
20801	1921	21,867.40
35835 (Transferee)	1921	21,867.40
27038	1922	58,422.79
40407	(1924	2,898.43
	(1925	10,965.80
42726	1926	17,663.58
49317	1927	20,177.14
52253	1928	3,061.39

In support of its petition, your petitioner respectfully represents to your Honorable Court as follows:

I.

Statement of the Controversy.

The nature of the controversy is as follows:

The alleged errors in determining the deficiencies relate to a 1,000-acre orange and walnut orchard in Orange County, California, and may be grouped as follows:

(a) Profits on Sale of Land.

During five of the tax years in question, an aggregate of 669 acres of the grove were sold at a profit, as follows:

Year	Acres	Profit Reported	Profit Claimed by Commissioner
1922	368.495	$472,688.80	$925,035.56
1925	46.3012	12,482.03	71,454.94
1926	95.976	17,470.76	110,230.49
1927	138.387	66,263.60	212,792.86
1928	20.019	14,637.84	37,997.04

The controversy in this respect turns on the proper basis of the orchard for purpose of determining gains on sales.

(b) Tree Depreciation.

Year	Depreciation Claimed
1920	$59,710.96
1921	59,710.96
1922	21,112.57
1924	21,081.84
1925	21,081.84
1926	13,364.40
1927	7,155.28
1928	6,355.28

Only a negligible amount of the claimed depreciation was allowed by the respondent. The controversy turns on the proper basis of the orchard for purpose of determining depreciation on the orange and fruit trees.

(c) Loss on Removal of Walnut Trees.

In 1926, twenty acres of walnut trees were removed. Loss of $14,272.00 was claimed; only $437.83 was allowed. The controversy turns on the proper basis of the orchard.

(d) Invested Capital.

This involves only two of the tax years, 1920 and 1921, and arises upon the Commissioner's refusal to include in invested capital, earned surplus and undivided profits of $1,659,372.85. The controversy is whether a closed transaction occurred on November 30, 1916. [238]

II.

Designation of Court of Review.

The petitioner is a corporation organized and existing under and by virtue of the laws of the State of California, with its principal office and place of business in the City of Tustin, State of California, and its income and profits tax returns for the years in controversy were filed with the Collector of Internal Revenue for the Sixth District of California, within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit, which Court is declared to be the Court in which review is sought by this petition. The respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue, appointed and holding his office by virtue of the laws of the United States.

III.

The petitioner says that in the record and proceedings before the Board of Tax Appeals, and in the decision and final order of redetermination rendered and entered by the Board of Tax Appeals, manifest error occurred to the prejudice of petitioner, and the petitioner assigns the following errors, which occurred in said records, proceedings, decision and final order of redetermination, which errors, and each of them, petitioner asserts and intends to argue: [239]

(1) The finding of the Board is unsupported by any evidence.

(2) The Board of Tax Appeals erred, as a matter of law, in ordering and deciding that there were deficiencies for the years 1920, 1921, 1922, 1924, 1925, 1926, 1927 and 1928.

(3) The Board of Tax Appeals erred in not ordering and deciding that there were no deficiencies for those years.

(4) The Board of Tax Appeals erred in deciding that the exercise of the option on November 30, 1916, was not a realizing transaction.

(5) The Board of Tax Appeals erred in deciding that the value of the land and improvements at November 30, 1916, was not the basis of the property for the years involved, for purposes of depreciation and gain or loss.

(6) The Board of Tax Appeals erred in deciding that the value of the land and improvements at November 30, 1916, was not the basis of the property for the years involved, for purposes of invested capital.

(7) The Board of Tax Appeals erred in deciding that the value of the land and improvements at March 1, 1913, was not the basis of the property for the years involved, for purposes of depreciation and gain or loss.

(8) The Board of Tax Appeals erred in not holding that the basis for depreciation or gain or loss should be the fair [240] market value as of March 1, 1913 of the option hereinbefore mentioned, together with subsequent cash payments.

(9) The Board of Tax Appeals erred in deciding that the value of the land and improvements at December 26, 1922, was not the basis of the property for the years 1924, 1925, 1926, 1927 and 1928.

(10) The Board of Tax Appeals erred in failing to make the following findings of fact proposed and requested by petitioner, each separate fact therein contained being here assigned separately and severally:

(a) In 1906, the 1,000 acres in question were bare and unirrigated land. It was part of a holding of approximately 100,000 acres owned by Irvine Company, a corporation, all of the stock of which, excepting some qualifying shares, was throughout 1906 (and continuously thereafter until 1920) owned by James Irvine, who dominated and controlled said corporation.

(b) In 1906, Sherman Stevens and C. E. Utt, experienced agriculturalists and orchardists, negotiated with James Irvine for the purchase of said 1,000 acres from the latter, for the purpose of developing it into orchard. The land was carefully selected out of said holding of 100,000 acres, and was well adapted for development into a citrus grove, and needed only the development of sufficient water for irrigation. There was no known water supply within or upon said 1,000 [241] acres, but there was a known, partially developed artesian supply of unknown quantity about two miles distant, upon the ten-acre tract hereinafter referred to. For the development of a citrus orchard, one flowing inch (a

stream of twelve gallons a minute) of water is sufficient for one acre of orchard, or 250 flowing inches for 1,000 acres. All other factors of success were present, and the development of sufficient water would make certain the successful commercial improvement of said 1,000 acres into orchard.

(c) Sherman Stevens and C. E. Utt at that time had cash capital of approximately $30,000.00 each, which they desired to use in capital expenditures in water development and in improvement of the said 1,000 acres, without application of any part thereof upon purchase price of the land. James Irvine desired to have that amount of cash capital increased through a pro rata contribution by himself, in order to be certain of the improvement of the 1,000 acres of land into orchard if sufficient water should be developed therefor.

(d) Accordingly, the negotiations resulted in: (1) the organization on October 5, 1906, of a California corporation named San Joaquin Fruit Company, with a capital stock of $100,000.00 divided into 1,000 shares of the par value of $100.00 each, of which 810 shares were issued to James Irvine, Sherman Stevens and C. E. Utt, for $81,000.00 cash paid in, [242] at the rate of $27,000.00 each; and (2) thereupon a lease of said 1,000 acres to San Joaquin Fruit Company for a term of ten years beginning December 1, 1906, and ending November 30, 1916, was caused by James Irvine to be made by Irvine Company.

(e) Thereunder, San Joaquin Fruit Company was required to set out and plant the whole of said 1,000 acres to orchard, within four years from October, 1906; and to enter upon a ten-acre tract of water-bearing land about two miles distant from said 1,000 acres, and sink wells for water and develop water to a volume of 250 flowing inches, and conduct it by pipe lines to said 1,000 acres, and irrigate the orchard thereon; and to raise crops of grain, beans, peanuts or other products on such portions of the land as could be cultivated without material injury to the trees. And, as a part of said lease and of the consideration thereof, Irvine Company granted to San Joaquin Fruit Company an irrevocable option, exercisable on November 30, 1916, to buy said 1,000 acres at a price of $200.00 an acre, or a total of $200,000.00 for the whole.

(f) The actual and real intention of the parties, at the time of entering into the lease and option, as aforesaid, in October, 1906, was a sale of said 1,000 acres to San Joaquin Fruit Company, contingent only upon the development of 250 flowing inches of water; and the payment of the purchase price of $200,000.00 to be deferred for ten years, so that the whole of the $81,000.00 cash capital of San Joaquin Fruit [243] Company might remain available to it for water development, orchard improvements, working capital, and the like.

(g) By the summer of 1907, several wells had been drilled by San Joaquin Fruit Company to depths of 200 to 400 feet on said ten-acre tract, a

pipe line therefrom to said 1,000 acres had been installed, and water was running to the highest elevation of said 1,000 acres, and within two years from October, 1906, the full 250 flowing inches of water in a continuous and certain supply had been fully developed and the whole of said 1,000 acres placed under full and adequate irrigation, and the success of the whole project, and the exercise of said option, had become certain, and was known and intended by all of the parties to be certain. The soil is a very deep, rich, alluvial soil, and said 1,000 acres rank, and on March 1, 1913, ranked, among the finest in California for successful commercial production of oranges, lemons and walnuts. By March 1, 1913, said 1,000 acres was fully improved with 400 acres of orange trees (140 acres 6-year old, and 260 acres 4-year old), and 600 acres of walnut trees (500 acres 6-year old, and 100 acres 4-year old).

(h) Within three years after October, 1906, San Joaquin Fruit Company had made a capital investment of $150,000.00 to $170,000.00 in developing and improving said 1,000 acres, with [244] an adequate and complete water system, wells, pumps, pipe line, irrigating system, trees, buildings, equipment, and the like. Throughout the period of ten years ending November 30, 1916, Sherman Stevens and C. E. Utt gave the whole of their personal time and labor to the project.

(i) Respectively, on March 1, 1913, and on November 30, 1916, fair market values of the land and trees were as follows:

	March 1, 1913	November 30, 1916
Whole Tract	$1,635,000.00	$2,150,000.00
400 acres bare orange land	400,000.00	400,000.00
600 acres bare walnut land	390,000.00	600,000.00
140 acres—orange trees	245,000.00	350,000.00
260 acres—orange trees	390,000.00	650,000.00
600 acres—walnut trees	210,000.00	150,000.00
140 acres—land and orange trees	385,000.00	490,000.00
260 acres—land and orange trees	650,000.00	910,000.00
600 acres—land and walnut trees	600,000.00	750,000.00

(j) The growth of value by March 1, 1913, was due primarily to (1) the full development of an adequate supply of water for irrigation, and (2) the proving and developing of said 1,000 acres as successful citrus and nut land, and (3) the provision of adequate financing of the project, and (4) the experience, ability, energy and creative work of Sherman Stevens and C. E. Utt.

(k) On March 1, 1913, the fair market value of the option was $1,360,000.00; and on November 30, 1916, when [245] exercised, its fair market value was $1,950,000.00.

(l) Said option was punctually and fully exercised on November 30, 1916, the purchase price of

$200,000.00 was paid, and legal title to the land was transferred to the San Joaquin Fruit Company.

(m) In July, 1922, the San Joaquin Fruit & Investment Company was incorporated with capital structure and corporate powers substantially different from those of the San Joaquin Fruit Company. On November 6, 1922, the San Joaquin Fruit & Investment Company acquired all (270 shares) of the capital stock of the San Joaquin Fruit Company. In exchange therefor it issued on November 8, 1922, 15,000 shares of its own stock to the former stockholders of the San Joaquin Fruit Company. The only exception was that Margaret R. Utt, who owned no stock in the old company, acquired 2,500 shares of stock in the new company.

(n) Thereafter, on December 26, 1922, the San Joaquin Fruit Company was liquidated and dissolved, all its properties being thereby acquired by the San Joaquin Fruit & Investment Company. Included in the properties so acquired were 600 acres of walnut orchards which then had a fair market value of $2,000.00 per acre, of which approximately $1,150.00 per acre represented the fair market value of the bare land. In addition, there were approximately 41 acres of orange orchards with a fair market value of $4,000.00 per acre, of which approximately $1,250.00 per acre [246] represented the fair market value of the bare land.

(o) The orange trees were not subject to depreciation during the first ten years after planting and thereafter were depreciable on the basis of a prospective life of thirty-five years. The walnut

trees were not depreciable during the first twenty years after planting and thereafter were depreciable on the basis of a prospective life of forty years.

(11) The Board of Tax Appeals erred in failing to make any finding of the value of the land and improvements at March 1, 1913.

(12) The Board of Tax Appeals erred in failing to make any finding of the value of the land and improvements at November 30, 1916.

(13) The Board of Tax Appeals erred in failing to make any finding of the value of the land and improvements at December 26, 1922.

(14) The Board of Tax Appeals erred in failing to make any finding of the value of the trees at March 1, 1913.

(15) The Board of Tax Appeals erred in failing to make any finding of the value of the trees at November 30, 1916.

(16) The Board of Tax Appeals erred in failing to make any finding of the value of the trees at December 26, 1922.

(17) The Board of Tax Appeals erred in failing to make any finding of the rate of depreciation of the trees, and the [247] time of beginning of depreciation.

(18) The Board of Tax Appeals erred in failing to find that on March 1, 1913, San Joaquin Fruit Company, a corporation, was practically and substantially the owner of the land and improvements.

(19) The Board of Tax Appeals erred in failing to find that on November 30, 1916, San Joaquin Fruit Company, a corporation, was practically

and substantially the owner of the land and improvements.

(20) The Board of Tax Appeals erred in denying petitioner's motion for judgment upon the ground that, as a matter of law, the evidence discloses that there is no deficiency.

WHEREFORE, the petitioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, and that the transcript of the record be prepared in accordance with the law and with the rules of said Court, and transmitted to the Clerk of said Court for filing and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Signed) JOSEPH D. PEELER,
819 Title Insurance Bldg.,
Los Angeles, California.

(Signed) GEORGE M. NAUS,
Alexander Building,
San Francisco, California.

(Signed) J. ROBERT SHERROD,
920 Southern Building,
Washington, D. C.
Counsel for Petitioner on Review.

Of Counsel.
MILLER & CHEVALIER,
Washington, D. C.
MILLER, CHEVALIER,
PEELER & WILSON,
Los Angeles, California. [248]

State of California
City and County of San Francisco—ss.

George M. Naus, being duly sworn, says: That he is one of the attorneys of record for the above-named petitioner and as such is duly authorized to verify the foregoing petition for review; that his office is in the City and County of San Francisco, in the State of California, and that the office and place of business of the petitioner is in the County of Orange, State of California, and that the residence of each of the officers of petitioner is in the latter county; that affiant has read the foregoing petition and is familiar with the statements therein contained and that the facts therein stated are true, except those stated upon information and belief, which facts affiant believes to be true:

(Signed) GEORGE M. NAUS.

Subscribed and sworn to before me this 20th day of October, 1933.

[Seal] (Signed) J. G. ROBERTS,
Notary Public in and for the City and County of San Francisco, State of California.

[Endorsed]: United States Board of Tax Appeals. Filed. Oct. 25, 1933. [249]

E. Barrett Prettyman, Esq.,
General Counsel,
Bureau of Internal Revenue,
Washington, D. C.
Attorney for Respondent.

In re: San Joaquin Fruit & Investment Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent — Nos. 6989, 20801, 27038, 40407, 42726, 49317 and 52253 before the United States Board of Tax Appeals.

Sir:

You are hereby notified that on the 25th day of October, 1933, a petition for review of the decision of the United States Board of Tax Appeals was filed with the Clerk of the Board in the case of San Joaquin Fruit & Investment Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent, and a true copy of said petition is herewith served upon you.

(Signed) J. ROBERT SHERROD,
920 Southern Building,
Washington, D. C.,
Attorney for Petitioner.

Receipt of copy of the above petition acknowledged this 25th day of October, 1933.

E. BARRETT PRETTYMAN,
Attorney for Respondent.

[Endorsed]: United States Board of Tax Appeals. Filed. Oct. 25, 1933. [250]

United States Circuit Court of Appeals
for the Ninth Circuit

Docket Nos. 6989, 20801, 27038, 40407, 42726, 49317 and 52253, before the United States Board of Tax Appeals.

SAN JOAQUIN FRUIT AND INVESTMENT COMPANY,

Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent on Review.

ORDER

In the Statement of Evidence now in course of settlement, in connection with the hearing had in above Docket Nos. 6989 and 20801, after reversal in this Circuit Court of Appeals in our No. 6346, it is

ORDERED, that the printed Transcript of Record in said No. 6346 may be incorporated simply by reference thereto in said Statement of Evidence, and such incorporation shall be a sufficient compliance with Rule 14 (3) of the Rules of this Court.

Dated, January 22, 1934.

(s) CURTIS D. WILBUR,
Senior United States Circuit Judge.

[251]

United States Board of Tax Appeals

Docket Nos. 6989, 20801, 27038, 40407, 42726, 49317, and 52253.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STATEMENT OF EVIDENCE

The above-entitled causes came on for hearing, and were heard, at Los Angeles, California, before Honorable H. F. Seawell, Member, United States Board of Tax Appeals, upon the 23rd and 24th days of May, 1932, petitioner being present by its attorneys, Messrs. Joseph D. Peeler and George M. Naus, and by Mr. N. L. McLaren, C. P. A., and respondent by his attorney, Mr. J. R. Johnston. The seven cases bearing docket numbers set forth above were consolidated for hearing and decision. Thereupon the following proceedings were had and evidence taken:

The respondent, before any evidence was taken, filed with the Board a written "Exception and Motion," whereby exception was taken to further hearing by the Board, on the merits, as to the cases docketed as B. T. A. Numbers 6989 and 20801, and motion was then made that the Board [252] then issue an order making the former decision of the

United States Circuit Court of Appeals, Ninth Circuit, in cause No. 6346, entitled David Burnet, Commissioner of Internal Revenue vs. San Joaquin Fruit and Investment Company, the judgment of the Board as to said two cases, docketed as Board of Tax Appeals numbers 6989 and 20801. Upon the suggestion of counsel for the petitioners that the question was a new one which they were not then prepared to argue, the Member deferred ruling on this motion until briefs were thereafter submitted covering all the issues in the case. The said motion of the respondent was thereafter denied.

Petitioner introduced in evidence the instrument of lease-option dated October 13, 1906, the substance of which is summarized in the Opinion of the Board. Petitioner then called

JAMES R. IRVINE,

as a witness, who being sworn testified:

In the year 1906 I, speaking of myself as the Irvine Company, owned approximately 100,000 acres of land in Orange County, California, the title to which was in Irvine Company, a corporation, all of the stock of which, except qualifying shares, was held by me; that situation continued from then until 1920. I had known C. E. Utt and Sherman [253] Stevens for many years prior to 1906 and knew that they were engaged in farming and agriculture, and more or less in the nursery business. (Witness here identifies said lease-option dated October 13, 1906.) The following question was propounded to the witness:

(Testimony of James R. Irvine.)

Question: "Tell me now, please, the general nature and scope and substance of the negotiations and discussions between you on the one side and Messrs. Utt and Stevens on the other, with respect to making this writing in your hand?"

Thereupon, before the witness answered, counsel for the Commissioner objected on the grounds that the contract in question was such as was required by the statute of frauds to be in writing; and the said contract was clear and unambiguous as to its terms; and any evidence as to preliminary negotiations or as to any collateral understanding with reference to the contract was inadmissible.

Thereupon, after argument and request of counsel for the petitioners before the Board that the evidence be received subject to later ruling after submission of briefs, the Member stated:

"I will permit you to put in the testimony and rule on it later. The parties are entitled to know my disposition to rule, and my disposition would be to say that you cannot vary this contract by parole testimony."

I recall the circumstances connected with the organization and formation of San Joaquin Fruit Company. It was organized for the special purposes indicated in that writing (referring to said lease-option). The general nature and scope and substance of the negotiations between me on the [254] one side and Messrs. Utt and Stevens on the other with respect to making said writing was

(Testimony of James R. Irvine.)

as follows: Mr. Utt and Mr. Stevens had been occupied in citrus work and Mr. Utt had spoken to me a number of times about wishing to buy some property to get a foothold and to set it out and to purchase part of the land on the ranch, but the question of water always stood in the way. We had a number of negotiations from time to time regarding this land, the sale of it to them. I remember very distinctly at the time of discussing the question of a lease, that Mr. Utt and Mr. Stevens both said they would not invest their entire capital in an enterprise that would not involve more than a lease. At any rate, the development of this property, so far as I know, it took the entire available capital of Mr. Utt and Mr. Stevens. We first discussed [255] a lesser amount of acres than 1,000 acres. I was fearful they could not develop and carry out the program in buying this 1,000 acres and being able to pay for it, it involved too much money; and as far as having them buy that land, I would have been very glad to have sold it to them, because if they developed it, it would benefit the rest of the property, but it was simply out of the question, they did not have the money, it could not be done. I think that the extent of the entire capital that Messrs. Utt and Stevens had available at that time to go into the project was around $30,000.00 apiece. The entire purchase and transaction hinged upon the development of some water; there was no water on the land so far as we knew and at that

(Testimony of James R. Irvine.)

time no water was obtainable on it, that is in any quantity to consider irrigation.

Question: "Was it discussed or was the location of the site at which you expected to develop water discussed"?

Answer: "We were quite confident we had water but we did not know how much. I don't recall whether there was flowing water at that particular time at that 10-acre site that the writing refers to as one development, at that particular [256] time. There had been flowing water at that site and farther to the east of it previously. It was in the artesian belt." (R. 43.)

The way it came about that I became not only the landlord but also a one-third owner in San Joaquin Fruit Company was this: for some reason Mr. Utt had a thousand acres in his mind, I tried to talk him out of it but he kept on prevailing on me to give him a thousand acres; I did not want to have them fall down and I felt they could not carry out a project that size at first with the amount of capital they had at that time and one discussion after another led to the result that we would join them and increase the amount of land to 1,000 acres, there being two of those gentlemen, making three. We joined with them on a one-third basis for the development of the property. We had a great deal to gain by having that property developed. San Joaquin Fruit Company, the corporation that was organized, was started with $81,000.00, or $27,-

(Testimony of James R. Irvine.)

000.00 apiece from me, Mr. Utt and Mr. Stevens. I felt that by increasing the immediate cash capital of $54,000.00 that they had put up, to $81,000.00 with the money I was to put in, they could successfully develop the project on the [257] $81,000.00 of capital. They were to do all the work, we were relieved of doing any work, actual detail administration. The $81,000.00 cash was to be used by them to set out orange trees and walnut trees on this tract of land. The writing was put in the form of a lease and option because I could not have sold it to them any other way, they could not have bought it; they did not have the financial capital to buy it, impossible. We make leases, thousands of them, and we have made many leases along this same line and I don't think you will find a man on this place that entered into one of those leases but that he later paid up on the contract. I was the draftsman of said lease-option.

In answer to the question, "What are the features of that writing that you had in mind as to making it possible to make the purchase with the same capital, as compared with an out and out deed with mortgage back, or by writing of some other kind," the witness answered (R. 45, 46):

Answer: "I figured the property itself was worth sufficient so they would be able to make that purchase at the end of the period of development."

[258]

(Testimony of James R. Irvine.)

Counsel for the Commissioner, at this point, interposed another objection to the testimony of the witness with reference to the lease on the ground that as to any matter involving its construction or terms, the lease spoke for itself and was the best evidence. Thereupon the Member stated: I agree with you at present, but I will allow the testimony to go in and you may have an exception noted."

The witness further testified: [259]

Questions by Mr. Naus:

Question: "What feature or features of this writing that was actually signed, did you have in mind that made a sure definite purchase and sale of that 1,000 acres?"

Answer: "Their available capital for the development of it; we carried the taxes and they were relieved from paying us interest, which they would have had to do on a so-called purchase contract." (R. 46.)

Question: "At the time of the negotiations, at the time of signing the writing, and since, has there or not ever been any doubt in your mind that the arrangement between you and Messrs. Utt and Stevens was that of purchase and sale?"

Answer: "No, sir." (R. 46.)

Mr. Johnston, counsel for the Commissioner: "That is the same objection, on the ground that the writing speaks for itself."

The Member: "It is very leading besides. Let it go in and I will rule on it later."

(Testimony of James R. Irvine.)

Mr. Naus, counsel for the petitioners before the Board: "If there is any objection, or rather, if there is any ruling, I would rather reframe it." [260]

The Member: "I will waive that myself. I suggest that you do not use the leading form any more than you have to." (R. 47.)

Questions by Mr. Naus: "Now, approximately how long was it, Mr. Irvine, if you recall, after the date of the writing that we have been speaking of, that the 1,000 acres was put out to trees, just roughly and approximately?"

Answer: "I think it was completed the third year." (R. 47.)

Question: "Mr. Irvine, at any time throughout the entire ten years would you or would you not have assented to an assignment of that lease or to a sale of the option, at the request of either Mr. Utt or Mr. Stevens, or both?"

Answer: "If proper people came into the picture, I would. I mean by that, if the people were reliable, depending upon receiving the proper compensation."

Question: "What I have in mind is particularly if they had found a cash buyer at any time, at whatever might have been a fair market value at any time, would you have consented to the execution of an assignment either of the lease or to the exercise of that option at anytime?"

Answer: "Either one." (R. 48.) [261]

Mr. Irvine was qualified as an expert on life of orange and walnut trees, and in answer to the ques-

(Testimony of James R. Irvine.)

tion—"State what, in your opinion, is the probable average life of the orange trees in that 1,000 acre grove," testified as follows: "I think that is a very difficult thing for any one to answer. I will say those trees should be probably from 30 to 40 years; all those trees are subject to insect and diseases and climatic conditions, the nature of the land they are put on; I don't think there is any such thing as the average life of an orange tree; too many qualifying factors. I think that grove should be good for 30 to 40 years. They may get to a point where they do not get enough to carry them and their expenses of upkeep, and the market conditions may be a factor."

Question: "What in your opinion is the probable average life of the orange trees in that location, assuming them to remain in the ground?"

Answer: "I think these trees will live much—what do you mean by average life?"

Mr. Naus: "Average life, commercial life?"

Answer: "Those trees there will be good for 30 to 40 years, as well as the walnuts." (R. 54.) [262]

Cross-examination:

This lease was not made between me personally and the San Joaquin Fruit Company, but was between the Irvine Company, a corporation, and the San Joaquin Fruit Company. I am an officer of the Irvine Company. When I say, if a request has been made of me for permission to transfer the lease or option or the rights under the option, that

(Testimony of James R. Irvine.)

I would have agreed to it under certain conditions, I mean that if I had continued to represent the Irvine Company and to have control of the Irvine Company during that entire period, that I would have agreed to an assignment or transfer of the option or lease. I do not know what contingencies that would be subject to, I could have transferred my stock in the Irvine Company, or might have died, and someone else might have succeeded me as president of the company. I do not think anybody could say what might have been done if I had been succeeded by someone else. When the lease was executed in 1906, Mr. Utt and Mr. Stevens each had available as capital about $30,000.00 each, which was not sufficient capital to purchase the property outright at that time, and I was doubtful as to their ability to carry out the terms of the lease as to the entire 1,000 acres. If they could have secured me on their [263] payments I would have entered into a contract of purchase, I would not have sold it to anybody who could not pay me for it.

Question: "But as I understand it, from your testimony, they only had about $30,000.00 each, and the lease was entered into because of the fact that they were not able to swing a sale."

Answer: "That was part of the reason. We had a great deal of land around there that was worth a great deal of money if we could develop it as citrus land; in fact, when they were taking that property over, people laughed at and ridiculed them, and

(Testimony of James R. Irvine.)

said it was just a sheep pasture; we had a great deal at stake and I was extremely fortunate in having two men of the type of these men to take hold of it."

Question: "You testified on direct examination that this lease was entered into because of the fact that their means were limited

Answer: That is right.

Question: And that this was the most appropriate form of contract in view of the means which they had at that time?

Answer: That is the only way I could make a sale to them. [264]

Question: I am not asking you whether you did or not. You at that time preferred to enter into this form of contract rather than a contract in the form of an out and out sale?

Answer: That was our way of handling the sale.

Question: That is not the question. Please answer the question as I asked you.

Answer: I thought we were selling the land, that is all; I don't know what other way to answer it.

Question: It is a fact, is it not, and you have testified substantially to that effect on direct examination, you selected this form of lease because of the fact they did not have sufficient capital to carry out a contract of sale?

Answer: That is right; they could not have paid me for it.

(Testimony of James R. Irvine.)

Question: Then you do recognize there is a difference between a contract such as this, or a lease and a contract of sale of the property?

Answer: Their whole talk was based on their buying that property.

Question: You mean that they could carry out all these terms and were able to exercise the option at the end of the 10 year period?

Answer: That is quite true. [265]

Question: You had doubts as to that?

Answer: I did not know. I felt that they could do it.

Question: Did you not say on your direct testimony that you had doubts about their being able to do it?

Answer: I said I did not know, but I felt that they could do it.

Question: Didn't you say you doubted their ability to do it?

Answer: Put it that way; it is the same thing.

Question: Now, do you know of your own knowledge what proportion of this 1,000 acres was planted to walnut trees and how much to citrus trees?"

Of the 1,000 acres, 400 were planted to citrus and 600 to walnuts, within the second or third year. I think the average useful commercial life of the walnut trees and the citrus trees is about the same. I am an officer of San Joaquin Fruit Company and am familiar with its affairs and was in full contact with its affairs during the years involved in this proceeding. Mr. Utt and Mr. Stevens handled most activities of the company, the same as our other

(Testimony of James R. Irvine.)

lessees did in many cases. In the operations that were carried on, the other income, besides income from trees, came from various crops, beans, [266] peanuts and things of that sort, which we have gradually eliminated as the trees increased in size, the way we did with the other of our orchards. After an orange tree is put out, it is pretty hard to answer as to how long it takes to reach a stage where it bears sufficiently to be commercially profitable. In our own case, we have had trees four years old, in which we had to pay an income tax of $250 an acre, and they said we could not pick fruit off from four year old trees. I testified on direct examination that San Joaquin Fruit Company was first capitalized for $81,000.00; I held one-third of the stock, Mr. Utt one third, and Mr. Stevens the other third, and that was true stockholders up to the time that the Fruit and Investment Company was organized and the property of the Fruit Company was transferred and distributed to the Investment Company. I would say that an orange tree in this particular location reaches its maximum production, after setting out, in about twelve to thirteen years; after reaching maximum production, it is my opinion that average useful life will hold up for twelve or fifteen years, depending on where they are located and you can hold production up much longer by applying artificial fertilizers. [267]

One of the kinds of business carried on by San Joaquin Fruit Company and also San Joaquin Fruit & Investment Company was the development

(Testimony of James R. Irvine.)

of land and orchards. I have no recollection of any program along the line of developing territory which had not been theretofore proven for citrus culture and selling the land out in parcels. The reason that they made various sales from time to time in 1922, 1925, 1926, 1927 and 1928, of various parcels of this land was because they thought they would receive a very high price for their orchards, purely a business transaction. They were pioneers in the field of orchard planting on my place; prior to this development this territory had not been proven because we had no water to begin with, nothing can be proven without water and that was the first move to be made.

Walnut trees, as a rule, have a longer useful life than orange trees. I question whether a walnut tree reaches its full stake of development at twenty years of age. I think that any tree increases in value as its production is increasing.

Question: "Now, it appears from some of these returns here which are in evidence, that some orange [268] trees were taken out along about 1926. Do you know when that was?

Answer: Just as I explained to you, they did not go on growing as we had expected they would.

Question: They were still useful, but they were not producing sufficiently, to bring a sufficient return as to the value of the land?

Answer: Not to be equivalent to what oranges would bring. My own oranges, although I had two or three thousand acres of it, more walnuts were taken out in Orange County, maybe more than that, by

(Testimony of James R. Irvine.)

reason of the price of oranges; although very foolishly I did on my own orchards. I would rather have them today than many of the orange orchards, but when the price of oranges was up, everybody wanted oranges.

Question: Then these trees were still producing when they were taken out, along in 1926 or 1927?

Answer: Yes.

Question: But you concluded at that time it would be more profitable to set the land to oranges?

Answer: That is right.

Mr. Johnston: That is all" [269]

Redirect examination:

In stating, on cross-examination, a doubt as to the ability of Mr. Utt and Mr. Stevens to carry out the project on the 1,000 acres, I had that doubt before I decided I would proceed with them and buy a one-third interest; after deciding to go in with them on a one-third interest, thereby increasing the capital by fifty per cent, I had no doubt remaining as to the success of the 1,000 acre project. Nothing further was needed to make the project a success, except the actual development of water on the 10-acre tract. I had no doubt, we would not have put in our own money if we had any doubt, any doubt about getting the water; I would not have been so insistent about developing the property, merely attempting to get water, we would have quit if we had not been able to. In 1906, I had surveyed the soil and knew the character of it and was entirely familiar with the climate, air currents, the amount of elevation, and

(Testimony of James R. Irvine.)

the like, and all factors affecting a citrus grove, excepting the one circumstance of whether or not enough water would be developed, and if the full amount of 250 inches had not been developed, we would have gone as far as we could, that is, if we had only 50 inches we probably would not have done anything, but if we had got any reasonable amount of water we would have gone as far as [270] that reached. In our development, we figured one inch of water to four acres of land, figuring twenty-five per cent safety factor.

Recross-examination:

There is a flowing inch of water and a miner's inch, but one is a continuous stream at 12 gallons a minute and the other 9 gallons a minute. One can allow twenty-five per cent safety margin and still carry four acres of citrus groves with a miner's inch of water. We figure that we use that, but sometimes they sand up, where we lose one well we have to make another one and keep them balanced.

Petitioners before the Board next called:

S. B. EDWARDS,
G. W. WHITSELL,
D. BLANKMYER,
C. A. PALMER,
J. W. SOURS and
JOHN L. WHEELER,

as witnesses who testified upon the question of value of the land and improvements, and of the option in-

corporated in said lease, at March 1, 1913, November 30, 1916, and December 26, 1922. All of this testimony was received subject to the objections and exceptions of counsel for the Commissioner as to relevance and materiality, and with the understanding that it was received subject to such rulings as might be made by the Member upon consideration of written arguments by briefs of counsel for the respective parties.

The Board made no finding as to value, based on any such testimony, and it is not spread in detail here.

Petitioner next called

G. B. MARTIEN

as a witness, who being sworn testified concerning the organization of petitioner in 1922, the transfer of assets to it, and the dissolution of San Joaquin Fruit Company, a corporation, in 1922, in substantial accordance with the Findings thereupon in the Opinion of the Board, and therefore his testimony is not spread in detail here. [271]

Petitioner next called

C. E. UTT

as a witness, who being sworn had propounded to him the following question:

Question: "Tell me, please, Mr. Utt, in substance, of the discussion between you and Mr. Stevens and Mr. Irvine with respect to the acquisition originally of the 1,000 acres in 1906?"

Thereupon, counsel for the Commissioner objected to any testimony as to any preliminary negotiations on the ground that such evidence was not admissible at all in this case.

In response to this objection the Member stated that he would allow the testimony to go in and stated further that if he ruled the evidence out the petitioners before the Board might have an exception, but if he ruled it in the Commissioner might have an exception, stating further that he was inclined to think the evidence was not competent.

The witness testified: Continuously from the beginning I have been President of the San Joaquin Fruit Company and San Joaquin Fruit & Investment Company. I recall the beginning of this project in 1906 between me and Mr. Stevens and Mr. Irvine. Mr. Stevens and I had been considering getting hold of a tract of land and I had spoken to Mr. Irvine a number of times, over a period of time, and in the summer of 1906 the matter began to take more form and shape, and Mr. Irvine did not think we had capital enough to make payment on the land

(Testimony of C. E. Utt.)

in cash and wanted us to take a lease [272] on the 1,000 acres, so we finally agreed to each take one-third of the stock of the San Joaquin Fruit Company to be organized to acquire this land. I think at no time did any of us consider but what we were purchasing the land. The Member thereupon stated:

"Mr. Witness, you have drawn a conclusion on that. The question was what was done between the parties."

The witness continuing, testified: The substance of what was said was that because of our meager capital the company was organized for $100,000.00 and only issued 81,000 shares; that we had better put all of our resources in the water system, the trees and buildings and pipe lines and improvements with which to carry it on, and so Mr. Irvine wrote out a lease which gave us an option. Each of the three of us put in $27,000.00 in this project to start with, or a total of $81,000.00 in cash. There was no water in this company, except what we put on the land. We developed water for irrigation on a small parcel near the 1,000 acres as part of the original project. The 10-acre piece on which we developed water, is about two miles away from the 1,000 acres. We struck a little water; there was swampy ground and old springs and artesian wells which proved it to have water, but we [273] had a little difficulty in developing water, so Mr. Irvine permitted us to spread it out over quite a scope of country there. There were natural springs flowing,

(Testimony of C. E. Utt.)

artesian springs you might call them. After said lease-option was signed, Mr. Stevens and myself did the actual work on the ground and Mr. Irvine only occasionally looked it over. I looked after the water development and the general farming operations and Mr. Stevens took special care of the trees. In developing the water we began by drilling several wells, I don't recall how many, and by July or August of 1907 we had some water running at the upper end or high spot of the ranch, and by the second year we had developed something like 200 inches and later we developed up to the full 250 inches mentioned in said lease-option. The wells ran around 300 or 400 feet deep; I think one was only 50 feet, one of our best wells, and it is still pumping. Since we developed water in 1907 and 1908, we have had a steady supply of water, an increasing supply, we now have 400 or 500 inches. We installed a pipe line between the 10-acre artesian tract and the 1,000 acres, with a booster plant, which raised the water to an elevation of something like 165 feet at the upper end or high spot of the 1,000 acres. At first we put in surface [274] irrigation and later, as we began to make money, we began to put the pipes under ground. I have been farming ever since childhood and had thirty years of experience before I signed said lease-option, principally around Tustin. I have raised many different kinds of crops; I planted my first orange tree when I was a small boy about thirty-six or thirty-seven years ago, just because I liked

(Testimony of C. E. Utt.)

oranges. In selecting the 1,000 acres from Mr. Irvine's large holdings, we selected what we thought would be the best for our purposes and we had set our hearts on this particular 1,000 acres as what we wanted. It is a very deep, rich, sandy loam, you dig thirty feet sometimes without striking gravel; it is an alluvial soil which never has been beat. In 1906 the 1,000 acres had been growing barley and beans and some of it had cactus and brush and ditches running across it. From my experience as a farmer in and about that territory, there was never any doubt in my mind that if I developed a flow of water, the land would be successful for citrus and nut culture. There was not a large amount of cactus left and we cleared it as quickly as we could and leveled down the hummocks and filled in the gulches to get it ready for planting as rapidly as possible with our resources. We planted 500 acres to walnuts interset with apricots. No one knew whether [275] walnuts or apricots would be more valuable and in the spring of 1915, we took the apricots out. We set out half of the oranges in 1907 and half in 1909. We used probably four acres for buildings and about six or seven acres for a little piece of nursery. All of the orange acreage was completed by the spring of 1909. In the earlier years, the 1,000 acres was very excellently adapted for intercropping of annual crops. The project was not self-supporting from the beginning, I think for four or five years we borrowed close to $100,000.00 besides our capital

(Testimony of C. E. Utt.)

in making development; I think in less than that time it began to be self-supporting and began to pay back all borrowed money and by 1916 we had paid back all our borrowed money and had money with which to make our first payment on the purchase price; I think two or three years after we started the project began to show a profit from operations. We had our capital investment pretty well along in two or three years excepting the care of the trees, which we always took out of the profits of farming. I think our capital investment amounted to between $150,000.00 and $170,000.00 by the end of three or four years. The form of that capital investment was as follows: primarily in getting the water, because water is first in the desert; [276] the cost of preparing the land, leveling it, putting in pipe lines, buying and setting out trees, building buildings, buying implements, growing the trees. In 1906, as soon as I knew the terms on which we were to take the 1,000 acres over, there was a certainty in my mind that we would exercise the option on the full 1,000 acres and from that time on I never had any doubt in my mind that we would exercise the option on the full 1,000 acres; if I had had any doubt, I would not have spent ten years and put in all of my money. During those ten years, we did not draw out any money, excepting that Mr. Stevens and I putting in all our time on it drew $100.00 a month cash, and Mr. Irvine drew no salary.

(Testimony of C. E. Utt.)

In my opinion, the probable average life of an orange grove on the 1,000 acres, as originally set out, is a matter of conjecture; on that kind of soil, you could hold those trees up to forty years and get commercial crops. In my opinion, the average life of the walnut trees would be up to forty or fifty years.

Question: "By the way, you finally did exercise the option in 1916, and acquired legal title to the property, didn't you?"

Answer: "No, we paid $50,000.00 down and then some later, in 1917 or 1918, we continued our payments [277] and took our title."

Question: "Punctually, according to what the writing calls for?"

Answer: "Yes, according to our contract."

Question: "And then got a deed for the legal title?"

Answer: "Yes."

We exercised the option in 1916, punctually, according to the contract.

The following tabulated statement was received in evidence as petitioner's Exhibit No. 4: [278]

(Testimony of C. E. Utt.)

SAN JOAQUIN FRUIT & INVESTMENT COMPANY

Statement Showing Gross Income from Commodities Grown by Company 1906 to 1922, Inc.

Year	Lima Beans	Blackeye Beans	Peanuts Nuts	Chili Peppers	Walnuts Trees	Walnut Nuts	Lemon Fruit	Orange Fruit	Apricots	Avacado & Sundry	Totals
1906	$ 575.16	$	$	$	$	$	$	$	$	$	575.16
1907	8,953.21		500.00								9,453.21
1908	7,180.00	285.74	6,537.30	3,954.91							17,957.95
1909	20,069.66	801.05	8,598.64	12,255.10	13.00		46.83				41,784.28
1910	13,834.07	1,551.77	500.00	13,459.60	2,029.50	34.40	1,920.72		996.70		34,326.86
1911	5,426.00	——	——	1,104.76	4,642.39	965.15	6,179.29	4,256.40	224.14		22,798.13
1912	15,564.86	2,805.08	——	1,026.40	4,145.84	8,108.59	13,333.62	13,060.32	11,094.33		69,139.54
1913	7,713.00	——	——	3,407.69	3,857.00	22,772.04	8,850.56	36,456.45	3,635.12		86,691.86
1914	15,099.44	——	——	——	1,261.12	24,893.50	20,871.00	42,201.68	13,618.50		117,945.14
1915	4,674.15	——	——	——	10.82	31,416.50	7,717.00	17,647.00	507.22		61,972.69
1916	4,818.70	——	——	——	——	33,268.00	38,879.60	12,875.90	208.80	650.33	206,101.33
"A"Tot.	103,908.25	5,443.64	16,135.94	35,208.46	15,959.67	121,458.18	97,798.62	241,898.25	30,284.81	650.00	668,746.15
"B"Adj.	34,646.08	1,814.55	5,378.64	——	——	47,579.23	32,599.54	80,632.75	10,094.94	216.00	212,952.51
"C"Tot.	138,544.33	7,258.19	21,514.58	35,208.46	15,959.67	169,037.41	130,398.16	322,531.00	40,379.75	867.00	881,698.66
1917	4,015.73	——	——	——	——	76,909.40	54,221.00	64,494.59	——	——	199,640.72
1918	5,590.02	——	——	——	——	102,492.19	105,630.73	240,761.50	——	——	454,475.44
1919	6,970.00	——	——	——	——	169,275.04	63,376.27	231,467.58	——	——	471,088.89
1920	7,510.52	——	——	——	——	56,396.24	52,933.54	316,028.09	——	——	432,953.74
1921	——	——	——	——	——	91,161.00	43,653.64	181,780.27	——	666.00	317,175.17
1922	——	——	——	——	——	103,732.00	——	491,027.05	——	——	594,759.05
"D"Tot.	24,086.27	——	——	——	——	599,965.87	319,815.18	1,525,559.08	——	666.00	2,470,092.01
"E"Tot.	127,994.52	5,443.64	16,135.94	35,208.46	15,959.67	721,424.05	417,613.80	1,767,457.33	30,284.81	666.00	3,138,838.16
"F"Tot.	162,630.60	7,258.10	21,514.58	35,208.46	15,959.67	769,003.28	450,213.34	1,848,090.08	40,379.75	867.00	3,351,790.67

Explanation:

"A". Three-fourths (¾ths) of gross returns from sale of various Ranch commodities produced by the San Joaquin Fruit Company from 1906 to 1916, inclusive, excepting Chilis and Walnut Nursery trees which are shown in full or 4/4ths. The returns shown from lemons and oranges are gross returns in-so-far as the general ranch cultural costs are concerned—these are not deducted, while the returns are net proceeds received from the lemon and orange packing house, the packing house, picking and hauling costs having been deducted. The reason for treating orange and lemon income in this manner is because the early records show only the net cash proceeds from packing houses.

"B". Represents the amount of rentals paid the Irvine Company from sale of various commodities raised and sold by the San Joaquin Fruit Company during the years of 1906 to 1916, inclusive, said rentals amounting to ¼th of the total gross income.

"C". Is the addition of "A" and "B". Represents the total proceeds, gross, from sale of all commodities sold in years 1906 to 1916, inclusive.

"D". This total represents all gross income from sale of various ranch commodities produced and sold by the San Joaquin Fruit Company during years from 1917 to 1922, inclusive. The returns shown from lemons and oranges are 100% gross returns, the packing house, picking and hauling costs not having been deducted as was done when treating returns from oranges and lemons for the years 1906 to 1916, inclusive, under paragraph "A". While packing house, picking and hauling costs are available and are shown on another sheet attached to this statement, it was thought proper to disregard these costs for 1917 to 1922, inclusive, in order to obtain a perfect gross figure.

"E". Represents the addition of "A" and "D" and is ¾ths of the total gross income received by the San Joaquin Fruit Company during the years of 1906 to 1916, inclusive, and the total perfect gross income received by the San Joaquin Fruit Company during the years 1917 to 1922, inclusive.

"F". Total of "C" and "D" showing gross income from all sources from 1906 to 1922, inclusive, including all rentals paid.

(Testimony of C. E. Utt.)

There was also received in evidence, as petitioner's Exhibit No. 5, a transcript of the capital stock record of San Joaquin Fruit & Investment Company, a corporation, showing that the original issue of the capital stock of said corporation was evidenced by forty-two certificates issued on November 8, 1922, to the following-named persons in the aggregate number of shares opposite their respective names:

Name	Total Shares
James Irvine	1
James Irvine, Jr.	1
The Irvine Company	4998
Sherman Stevens	5000
C. E. Utt	2500
Margaret R. Utt	2500
Total issued	15000 Shares

Said record further shows that the said stock issue, and the said certificates, remained unchanged continuously until October 22, 1925, from which time onward the record shows occasional transfers of shares and certificates from time to time.

It was thereupon agreed by counsel for the respective parties that the former testimony of N. L. McLaren, appearing in the Transcript of Record of Cause No. 6346, Circuit Court of Appeals for the Ninth Circuit, beginning at page 177 of said Transcript, might be considered and deemed as given in this cause [280] (R. 262).

Thereupon petitioner rested.

Thereupon the Commissioner called in rebuttal:

W. A. COOK,
F. E. McCARDER and
JOHN C. WALLACE.

Said witnesses gave certain testimony, in rebuttal tending to prove the March 1, 1913 value and the value at November 30, 1916, respectively, of the 1,000 acres of land, covered by the lease, with option to purchase, and the orange and walnut trees thereon at the respective dates.

Inasmuch as the Board made no findings of value, the said testimony is not set out herein.

Respondent introduced in evidence, as his Exhibits A and H, pamphlets prepared by the Agricultural Extension Service, University of California, cooperating with the Orange County Bureau, setting forth studies of orange and walnut groves respectively, in Orange County, [281] California, where the petitioner's groves were situated. The 1930 pamphlet relating to Valencia oranges (being the kind of oranges here involved), on page 4, has the following statement with respect to depreciation:

> "Tree values are computed on a depreciation basis of forty-five years, which is generally agreed to be the average life of a commercial citrus orchard under Southern California conditions. The investment in ten-year-old trees,

for instance, is the cost of bringing those trees up to that age, which has averaged $1085 per acre. For the purposes of this study the appraised valuation of trees was depreciated $31.00 per acre per year, beginning at the tenth year and completing at the forty-fifth year."

The 1930 pamphlet relating to walnut groves in Orange County, has, on page 16, the following statement with respect to depreciation:

"Tree values are computed from a replacement schedule based on sixty years' life for an average commercial walnut orchard. The values starting at $75.00 the first year were appreciated $27.00 per year to the 12th year and then $18.75 to a maximum value of $550.00 per acre the 20th year. A depreciation rate of 2.5% per year, or $13.75, is made from the 20th to the 60th year. No depreciation is charged during the first twenty years."

There was also received in evidence, as respondent's Exhibit B, the income statement hereinabove referred to [282] as having been received in evidence as petitioner's Exhibit No. 4, which is fully inserted hereinabove and therefor is not repeated here.

There was also received in evidence, as respondent's Exhibit J, the original Corporation Income Tax Return of San Joaquin Fruit Company for the calendar year 1922, captioned in the name of said company, with address at Tustin, California, date of incorporation October 5, 1906, under the

laws of the State of California, and with kind of business stated as Agricultural, Fruit Growing & Development of Lands and Orchards; and signed and verified under date of May 25, 1923, by C. E. Utt as President and C. V. Newman as Acting Treasurer, before a notary public in Orange County, California. The balance sheet under Schedule K thereof at the "End of Taxable Period" was as follows: [283]

Items	Amount	Total
ASSETS		
1. Cash		$ 150.00
2. Notes receivable		189,850.00
3. Accounts receivable	$858,863.08	
Less reserve for bad debts		858,863.08
4. Inventories		21,242.49
5. Investments (describe fully):		
U. S. Bonds	213,500.00	
Other Bonds	141,392.28	
Stocks	677.06	355,569.34
6. Loans (describe fully):		
Mortgages Receivable	83,307.08	83,307.08
7. Deferred charges:		
Prepaid insurance	750.58	730.58
8. Capital assets:		
Land and Trees		278,077.59
Buildings	72,480.01	
Machinery and equipment	40,146.21	
Furniture and fixtures	4,429.59	
Delivery equipment	35,093.50	
Less reserves for depreciation and depletion		152,149.31
12. Total Assets		$1,939,939.47

LIABILITIES

14. Accounts payable		$ 949.91
16. Other liabilities (describe fully):		
Reserve-Depreciation	$163,291.18	163,291.18
17. Capital stock:		
Common stock (less stock in treasury)		81,000.00
19. Undivided profits		1,694,698.38
Total liabilities		$1,939,939.47

The "Reconciliation of Net Income and Analysis of Changes in Surplus," under Schedule L of said return, was as follows: [284]

1. Net Income from Item 25, page 1, of the return	864,154.06
2. Nontaxable income:	
(a) Interest on obligations of the United States and its possession	791.34
(b) Interest on obligations of States, Territories, and Political Subdivisions thereof	579.04
(d) Dividends deductible under Section 234 (a) (6) of the Revenue Act of 1921	539.34
(f) Other items of nontaxable income (to be detailed):	
(1) Adjust Book Profit Sale Capital Assets	494,003.01
5. Total of Lines 1 to 4, inclusive	$1,360,066.79
6. Total from Line 14	13,404.28
7. Net Profit for year as shown by books, before any adjustments are made therein (Line 5 minus Line 6)	$1,346,662.51
8. Surplus and undivided profits as shown by balance sheet at close of preceding taxable period	468,035.87

10.	Total of Lines 7 to 9, inclusive	$1,814,698.38
11.	Total from Line 17	120,000.00
12.	Surplus and undivided profits as shown by balance sheet at close of taxable period (Line 10 minus Line 11)	$1,694,698.38
13.	Unallowable deductions:	
	(b) Income and profits taxes paid to the United States, its possessions, or foreign countries	7,672.88
	(j) Other unallowable deductions (to be detailed)	
	(1) Depreciation Trees sold 1922 charged on books but not on return	5,731.40
14.	Total of Line 13	$ 13,404.28
15.	Dividends paid during the taxable period (State whether paid in cash, stock of this company, or other property):	
	(a) Date paid—Various—Character—Cash	120,000.00
17.	Total of Lines 15 and 16	$ 120,000.00

There was also received in evidence, as respondent's Exhibit K, a batch of documents relating to the dissolution of San Joaquin Fruit Company, which documents are duplicates of the [285] documents appearing at pages 205-225, both inclusive, of the Transcript of Record in case No. 6346, hereinafter referred to.

There was also received in evidence, as respondent's Exhibits L-1, L-2 and L-3, a letter of transmittal and two waivers, reading as follows:

EXHIBIT L-1

C. E. Utt,
President
James Irvine
Vice-President
Sherman Stevens
Secretary-Treasurer
C. V. Newman,
Manager

SAN JOAQUIN FRUIT & INVESTMENT COMPANY
Member of
California Fruit Growers' Exchange
California Walnut Growers' Association
California Lima Bean Growers' Association
California Avocado Growers' Exchange

Tustin, California,
Feb. 9, 1926.

Commissioner of Internal Revenue,
Washington, D. C.

Dear Sir:

In accordance with your request of February 3, 1926, IT:CA:2554-11, we are enclosing INCOME AND PROFITS TAX WAIVER for the year 1921, signed by the President of the San Joaquin Fruit & Investment Co. and sealed.

Kindly acknowledge receipt of this letter.

Respectfully,
SAN JOAQUIN FRUIT & INVESTMENT CO.
By (Signed) G. B. Martien.

GBM:HJK [286]

EXHIBIT L-2

Treasury Department
Internal Revenue Service
Form 872A

INCOME AND PROFITS TAX WAIVER FOR TAXABLE YEARS ENDED PRIOR TO JANUARY 1, 1922

IT:CA:2554-7-60D February 8, 1926.

In pursuance of the provisions of existing Internal Revenue Laws San Joaquin Fruit Company, a taxpayer of Tustin, California, and the Commissioner of Internal Revenue hereby waive the time prescribed by law for making any assessment of the amount of income, excess-profits, or war-profits taxes due under any return made by or on behalf of said taxpayer for the year 1921 under existing revenue acts, or under prior revenue acts.

This waiver of the time for making any assessment as aforesaid shall remain in effect until December 31, 1926, and shall then expire except that if a notice of a deficiency in tax is sent to said taxpayer by registered mail before said date and (1) no appeal is filed therefrom with the United States Board of Tax Appeals then said date shall be extended sixty days, or (2) if an appeal is filed with said Board then said date shall be extended by the number of days between the date of mailing of said notice of deficiency and the date of final decision by said Board.

SAN JOAQUIN FRUIT & INVESTMENT CO.
Taxpayer
By (Signed) C. E. UTT

(Signed) D. H. BLAIR
C
Commissioner.

[Corporation Seal]

If this waiver is executed on behalf of a corporation, it must be signed by such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation, in addition to which, the seal, if any, of the corporation must be affixed. [287]

EXHIBIT L-3

October 31, 1925.

IT:CA:2554-11

INCOME AND PROFITS TAX WAIVER

In pursuance of the provisions of existing Internal Revenue Laws, San Joaquin Fruit and Investment Company, a taxpayer of Tustin, Orange County, California, and the Commissioner of Internal Revenue, hereby consent to extend the period prescribed by law for a determination, assessment, and collection of the amount of income, excess-profits, or war-profits taxes due under any return made by or on behalf of said taxpayer for the year 1921 under the Revenue Act of 1924, or under prior income, excess-profits, or war-profits tax Acts, or under Section 38 of the Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909. This waiver is in effect from the date it is signed by the taxpayer and will remain in effect for a period of one year after the expiration of the statutory period of limitation within which assessments of taxes may

be made for the year or years mentioned, or the statutory period of limitation as extended by Section 277 (b) of the Revenue Act of 1924, or by any waivers already on file with the Bureau.

SAN JOAQUIN FRUIT AND
INVESTMENT COMPANY
By (Signed) C. E. UTT
Pres.

COMMISSIONER: D. H. BLAIR (Signed)
[Corporation Seal] [288]

There was also received in evidence, as respondent's Exhibit M, a document headed "Statement of Protest with Respect to Additional Income Tax Recommended for Assessment by the Supervising Internal Revenue Agent Against the San Joaquin Fruit Company, Tustin, California, for the year 1922." Said document is signed and executed as follows:

"San Joaquin Fruit and Investment Co.,
Successor to
San Joaquin Fruit Company,
By C. E. Utt,
President."

It contains, among other things, the following statement:

"On October 5, 1906, this company leased from the Irvine Company, 1,000 acres of land, etc. * * *."

Said document, Exhibit M, is verified by the affidavit of C. E. Utt, executed before a Notary Public November 6, 1926, who states therein the following:

> "* * * That he is the president of the San Joaquin Fruit and Investment Company, a corporation which succeeded the San Joaquin Fruit Company upon reorganization of said company at or about the close of the year 1922, and that he was also the president of the San Joaquin Fruit Company * * *."

There was also received in evidence, as a joint exhibit for petitioner and respondent the printed Transcript of Record in Docket 6346 of the United States [289] Circuit Court of Appeals for the Ninth Circuit, which Transcript of Record is herein incorporated fully by reference, with the same effect as though here copied at length and in full, pursuant to an order of said Circuit Court of Appeals in Docket Nos. 6989, 20801, 27038, 35835, 40407, 42726, 49317 and 52253, reading as follows:

> "ORDER
>
> In the Statement of Evidence now in course of settlement, in connection with the hearing had in above Docket Nos. 6989 and 20,801, after reversal in this Circuit Court of Appeals in our No. 6346, it is
>
> ORDERED, that the printed Transcript of Record in said No. 6346 may be incorporated simply by reference thereto in said Statement of Evidence, and such incorporation shall be a

sufficient compliance with Rule 14 (3) of the Rules of this Court.

Dated, January 22, 1934.

(Signed) CURTIS D. WILBUR
Senior United States Circuit Judge."

Respondent rested.
Petitioner rested.

Such former hearings and proceedings with reference to Docket Nos. 6989 and 20801, for the taxable years 1920 and 1921, respectively, were had before the Board as found by it and as shown by the Transcript of the [290] Record in Cause No. 6346 above referred to." The Circuit Court of Appeals reversed the decision of the Board as to the aforesaid docket numbers, for the taxable years 1920 and 1921. On August 4, 1931, after the receipt of the Court's mandate to that effect commanding "that such further proceedings be had in such cause as according to right and justice and the laws of the United States ought to be had," the Board, upon its own motion, placed Docket Nos. 6989 and 20801, applicable to the years 1920 and 1921, respectively, on its Day Calendar for hearing on the merits at Washington, D. C., on October 5, 1931. Thereafter the Commissioner consented to the transfer of the proceedings with reference to Docket Nos. 6989, 20801, 27038, 35835, 40407, 42726, 49317 and 52253, "to the Circuit Calendar for hearing at Los Angeles, California.

At the conclusion of all of the evidence, petitioner moved the Board, separately under each Docket, for a [291] judgment in favor of petitioner, upon the ground that, as matter of law, the evidence discloses that there is no deficiency, and without waiving the foregoing motion for judgment, petitioner move the Board to make special findings, in accordance with a draft of proposed Findings of Fact, in paragraphs numbered I to XV, both inclusive, a full and true copy whereof is contained in the Assignment of Error numbered 8 in petitioner's Petition for Review by the Circuit Court of Appeals, Ninth Circuit, and here incorporated as fully as though copied in full.

JOSEPH D. PEELER,
819 Title Insurance Bldg.,
Los Angeles, California.
GEORGE M. NAUS,
Alexander Building,
San Francisco, California.
(Signed) J. ROBERT SHERROD,
920 Southern Building,
Washington, D. C.
Counsel for Petitioner.

[Endorsed]: United States Board of Tax Appeals. Filed March 21, 1934. [292]

The foregoing Statement of Evidence is hereby approved as a full, true and correct statement of all of the evidence relative and material to the issues

presented by the Petition for Review, and is approved and signed and ordered to be made a part of the record.

Dated, Washington, D. C., this 21 day of March, 1934.

(s) H. F. SEAWELL
Member, United States Board of Tax Appeals. [293]

[Title of Court and Cause—Consolidated Cases.]

SECOND AMENDED PRAECIPE

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, and within the time as extended by the Board transmit to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit certified copies of the following documents, disregarding the requests heretofore made in the original Praecipe and in the first Amended Praecipe:

1. The docket entries of proceedings before the United States Board of Tax Appeals.
2. Pleadings before the Board.
3. Opinion and decision of the Board.
4. Petition for review.
5. Notice of filing petition for review.
6. Statement of the evidence settled or agreed upon. [294]
7. Order dated January 22, 1934, signed by Hon. Curtis D. Wilbur, Senior United States Cir-

cuit Judge, Ninth Circuit, now on file with the Clerk of said Board.

8. This second amended praecipe.

The foregoing to be prepared, certified and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Ninth Circuit.

J. ROBERT SHERROD (Signed)
920 Southern Building,
Washington, D. C.
Attorney for Plaintiff.

Service of a copy of the above second amended praecipe acknowledged this 22nd day of May, 1934.

ROBERT H. JACKSON
General Counsel,
Bureau of Internal Revenue,
Attorney for Respondent.

[Endorsed]: United States Board of Tax Appeals. Filed May 21, 1934. [295]

[Title of Court and Cause—Consolidated Cases.]

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 295, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 24th day of May, 1934.

[Seal] B. D. GAMBLE
Clerk,
United States Board of Tax Appeals.

[Endorsed]: No. 7505. United States Circuit Court of Appeals for the Ninth Circuit. San Joaquin Fruit & Investment Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filed May 29, 1934.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 7505

SAN JOAQUIN FRUIT & INVESTMENT COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Proceedings had in the United States Circuit Court of Appeals for the Ninth Circuit

At a stated term, to wit, the October 1934 of the United States Circuit Court of Appeals for the Ninth Circuit, held in the court room thereof, in the city and county of San Francisco, in the State of California, on Friday, the first day of March, in the year of our Lord one thousand nine hundred and thirty-five:

Present: Honorable Curtis D. Wilbur, Circuit Judge; Honorable Francis A. Garrecht, Circuit Judge.

No. 7505

SAN JOAQUIN FRUIT & INVESTMENT COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Order of submission

Ordered above-entitled cause argued by Mr. George M. Naus, counsel for petitioner, and by Mr. Francis A. LeSourd, Special Assistant to the Attorney General, counsel for respondent, and submitted to the court for consideration and decision.

At a stated term, to wit, the October 1934, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the court room thereof, in the city and county of San Francisco, State of California, on Monday, the twentieth day of May, in the year of our Lord one thousand, nine hundred and thirty-five:

Present: Honorable Curtis D. Wilbur, Circuit Judge; Honorable William Denman, Circuit Judge; Honorable Clifton Mathews, Circuit Judge.

In the matter of the filing of certain opinions and of the filing and recording of certain judgments and decrees

By direction of the court, ordered that the typewritten opinion this day rendered by this court in each of the following causes be forthwith filed by the clerk, and that a judgment or decree be filed

in each of said causes and recorded in the minutes of this court in accordance with the opinion filed therein: * * * *San Joaquin Fruit & Investment Company* vs. *Commissioner of Internal Revenue.* * * *

United States Circuit Court of Appeals for the Ninth Circuit

No. 7505

SAN JOAQUIN FRUIT & INVESTMENT COMPANY, PETITIONER
vs.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

May 20, 1935

Upon petition to review an order of the United States Board of Tax Appeals.

Before WILBUR and GARRECHT, Circuit Judges.

WILBUR, *Circuit Judge:*

Petitioner appeals from a decision of the Board of Tax Appeals confirming deficiencies determined by the Commissioner of Internal Revenue in income taxes for the years 1920 to 1922 and 1924 to 1928, inclusive. The income sought to be taxed by the Commissioner was in part derived from the sale of portions of a 1,000-acre tract of land in Orange County, California. The dispute arises as to the basis upon which is to be determined the amount of capital included in the sales price and the basis upon which depreciation on the orchards should be determined. Some of the land was sold by petitioner's predecessor in the year 1922 and the balance herein involved was sold by petitioner in the years 1924 to 1928, inclusive.

In *Burnet, Comm'r* v. *San Joaquin Fruit and Investment Co.*, 52 F. (2d) 123, this court held that the present petitioner having succeeded to its predecessor's (San Joaquin Fruit Company) assets was the "taxpayer" and liable for deficiencies, if any, in income taxes of its predecessor.

The petitioner, San Joaquin Fruit and Investment Company, was incorporated in July 1922, under the laws of the State of California, with a capital stock of $1,500,000 divided into 15,000 shares each of the par value of $100.00. The petitioner, on November 8, 1922, issued its stock in exchange for the stock of the San Joaquin Fruit Company and petitioner concedes that this transaction was a statutory reorganization and no gain or loss was realized by the individual stockholders who exchanged their stock. Thereafter, on December 26, 1922, the San Joaquin Fruit Company was liquidated and dissolved by order of court, the petitioner as sole stockholder taking over all of its assets upon liquidation. Petitioner contends that since the liquidation of a corporation is a realizing transaction, the basis for the determination of gain or loss from sale of the

property after December 26, 1922, is the fair market value of the property on the date of liquidation. The findings of the Board of Tax Appeals as stated in its opinion are in part as follows:

"The exchanges of stock by which the petitioner acquired all but three shares of the stock of the Fruit Co. and the old stockholders of that corporation received about 83 percent of the stock of the petitioner, together with the calling of a meeting of the stockholders of the Fruit Co. for November 18, 1922, to consider the matter of dissolving the Fruit Co., all occurred on November 6, 1922. Within three days after the stockholders acted to liquidate the affairs of the Fruit Co., application was made to the appropriate court for a dissolution decree. After advertisement as required by law and on a date set by the court at the first hearing, a further hearing was had on the application. The hearing resulted in a decree of the court for the dissolution of the Fruit Co. and the transfer of all its assets to petitioner, its sole stockholder, the outstanding qualifying shares having previously been transferred to it. Except for the period of about 12 days that could have been saved by obtaining waivers from the stockholders for the meeting held on November 18, 1922, the proceedings were carried out in practically the shortest possible time. When these steps had been completed, all within about one and one-half months, and the original stockholders of the Fruit Co. held about 83 percent of the petitioner's stock. Under these circumstances we conclude that the assets of the Fruit Co. were not acquired in liquidation proceedings, as contended by the petitioner, but in connection with a reorganization."

The Board of Tax Appeals, therefore, held that under §§ 204 (a) (7) and 203 (h) (d) of the Revenue Act of 1924 the basis for determining gain or loss from the sale of portions of the land in 1924 and subsequent years, is the same as it would have been in the hands of the transferor (San Joaquin Fruit Company). We agree with this conclusion. As was said in *Ahles Realty Corp.* v. *Comm'r.*, 71 F. (2d) 150, a single transaction may not be broken up into various elements to avoid a tax. The basis for determining gain or loss to petitioner from sale of the property herein involved being the same as it would have been had petitioner's precedessor, San Joaquin Fruit Company, remained the owner thereof and had sold it, we now proceed to a consideration of what that basis is. The applicable statutes provide that in case the property was acquired after March 1, 1913, the basis for determining the capital investment to be deducted from the selling price is the cost of the property, whereas, if it were acquired previous to March 1, 1913, the market value on that date, or the cost thereof, whichever is greater is to be considered the capital investment in determining the gain derived from the sale. (Rev. Act. 1918, 40 Stat. 1057, § 202 (a) (1) (2); Rev. Stat. 1921, 42 Stat. 227, § 202 (a) (b) (1) (2); Rev. Act. 1924, 1926, § 204 (a) (b), Rev. Act. 1928, §§ 113, 114.

The difficulty of applying this provision arises in the case at bar from the fact that the petitioner's predecessor secured an option to purchase the land in 1906 and exercised the option in 1916 so that the question is whether or not the property was "acquired" within the meaning of the Revenue acts when the option was given, or when the option was exercised. The 1,000 acres of land in question was owned by the Irvine Company in 1906. It was uncleared, desert land, overgrown with sage brush, cactus and similar vegetation. The utility of the land depended upon obtaining an adequate supply of water for irrigation. The Irvine Company also owned land upon which there were indications of an underground water supply. It was thought that by developing this supply by artesian wells and otherwise, a sufficient supply of water could be obtained to irrigate the land, justifying the improvement of the land by planting orange and walnut trees. In order to promote such development the lease and option involved in this case were made by the Irvine Company as lessor to the San Joaquin Fruit Company which was organized for the purpose of acquiring the lease and option upon the property which had been negotiated by its promoters, C. E. Utt and Sherman Stevens. The lease provided that the lessee should take possession of the property, develop the water supply, plant orange and walnut trees on the land, utilize the land for the production of other crops while the trees were maturing, and pay therefor during the ten-year term, one-fourth of such crops. The lessee was given the option to purchase all the land at the end of ten years for the sum of $200,000, or to purchase at $200 per acre not to exceed half the land during the life of the lease. An exercise of the right to purchase portions of the tract during the life of the lease worked a termination of the option to purchase all of the tract on the expiration of the term of the lease. We are only concerned with the former provision of the lease because the option was exercised in toto at the end of the ten-year term. Before the 1st of March 1913 an adequate water supply had been developed and a large part of the area had been set out to trees, thereby greatly enhancing the value of the property. It is claimed by the petitioner that the value of the option on March 1, 1913 was $1,360,000 and that the value of the option on November 30, 1916, when exercised was $1,950,000; that the value of the land on the former date was $1,635,000, and on the latter date $2,150,000. Evidence was introduced to support this claim but the Board of Tax Appeals deemed it unnecessary to make a finding on the question because of its decision holding that the property was acquired in 1916 at the time the option was exercised, and that its cost was the option price of $200,000, plus the amount expended in developing and improving the property. The Board of Tax Appeals found that by the close of 1910 the lessees had expended between $150,000 and $170,000 in developing and improving the tract. It is quite clear from the decision of the Board of Tax Appeals that the increase in value due to the improvements made upon the property and to the develop-

ment of an adequate water supply before March 1, 1913, less their cost, was included in the taxable income, as fixed by the Commissioner and approved by the Board of Tax Appeals. In determining whether or not this increase in value accruing before March 1, 1913, was properly included, consideration must be given to the constitutional and legislative history of the income tax provisions. Prior to the adoption of the Sixteenth Amendment to the Constitution it was held by the Supreme Court in *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, that Congress had no power, without apportionment of the tax among the several States in proportion to population, to impose an income tax upon gains or profits arising from real estate for the reason that such a tax was a direct tax under art. I, sec. II, clause 3, and art. I, sec. IX, clause 4 of the Constitution. The respondent contends that by virtue of the sixteenth amendment Congress has power to tax gains realized after the adoption of the sixteenth amendment, although such gains represent in part an increase in the value of the property accruing before the adoption of the sixteenth amendment and cites in support of this contention *Lynch* v. *Hornby*, 247 U. S. 339, *Eisner* v. *Macomber*, 252 U. S. 189. This question was expressly reserved by the Supreme Court in deciding the case of *Lucas* v. *Alexander*, 279 U. S. 573, dealing with the taxability of moneys derived from life insurance companies where income had accumulated thereon prior to the 1st day of March 1913. The court in that regard stated:

"But of this total gain received by the insured, a part is attributable to and accrued during the period before the effective date of the sixteenth amendment (February 25, 1913), and of the first law taxing the income of individuals (March 1, 1913), and hence, for income tax purposes, must be deemed an accretion to capital not taxable by the income tax acts enacted under the sixteenth amendment. See *So. Pac. Co.* v. *Lowe*, 247 U. S. 330, 334; cf. *Doyle*, v. *Mitchell Bros. Co.*, 247 U. S. 179; *Lynch* v. *Turrish*, 247 U. S. 221. Whether or not such accretions may be constitutionally subjected to tax, we have no occasion to decide. The present act, at least, does not attempt it. But the question presented necessarily involves a determination of what part of the total gain received by the taxpayer accrued to him after March 1, 1913. In answering it, provisions of the taxing statute enacted as aids in arriving at the answer must be construed with an eye to possible constitutional limitations so as to avoid doubts as to its validity. *U. S.* v. *Delaware & Hudson Co.*, 213 U. S. 366, 407, 408; *U. S.* v. *Standard Brewery*, 251 U. S. 210, 220; *Texas* v. *Eastern Tex. R. R. Co.*, 258 U. S. 204, 217; *Bratton* v. *Chandler*, 260 U. S. 110, 114; *Panama R. R. Co.* v. *Johnson*, 264 U. S. 375, 390."

Aside from the question of constitutional power which we find it unnecessary to determine, it is clear that Congress in its legislation imposing income taxes throughout has indicated an intention not to impose a tax upon gains in property value accruing before the adoption of the sixteenth amendment. In considering the problem

presented by the record it should be kept in mind that the power of Congress to tax such increases accruing prior to the adoption of the sixteenth amendment, is doubtful, where there is no apportionment of the tax to the several states as is required by the Constitution for the imposition of a direct tax, and also that in the various revenue acts passed by Congress it has attempted to exclude from the income tax provisions increments or gains to property which accrued prior to the enactment of the Revenue Act of 1913 (March 1, 1913). The question is whether under the peculiar circumstances of this case relating to an option granted before March 1, 1913 and exercised after that date, the language of the act requires or permits an imposition of a tax on the capital gains accruing prior to March 1, 1913. In effect, the contention of the respondent is that the word "acquired" in § 202(a) (2) of the Revenue Act of 1918 and similar provisions of the later revenue acts construed with technical nicety, requires the imposition of a tax upon the gain of $1,000,000 or more in the value of the real estate which accrued between 1906 and March 1, 1913. It is clear that if the original owner had not parted with the property until 1916 and had sold the property at that time for its market value, that the owner would not be taxable for that portion of the purchase price which represented gains in value between 1906 and March 1, 1913. Similarly, if an agreement to purchase had been entered into between the owner and the lessee in 1906, it is equally clear that the purchaser would not be required to pay a tax upon the increase in its value prior to March 1, 1913, when it later sold the property and realized a gain. The decision of the Board of Tax Appeals is based upon its conclusion that the taxpayer acquired no interest in the property prior to the exercise of the option to purchase in November, 1916. Whether or not the holder of an option has an interest in the real estate covered by the option in a strict technical sense is not necessarily determinative in deciding the applicability of the income tax laws. It has been frequently said that the court looks to the substance of the transaction rather than to the technical niceties in determining the applicability of the taxing statutes, although, in the administration of the revenue laws much depends upon the statutes of the various states controlling the significance and effect of the transaction involved.

Under the law of California it is clear that the option contained in the lease gave to petitioner's predecessor such a right as will be protected in equity. *Gordon* v. *Dufresne*, 205 Cal. 512; *Chapman* v. *Great Western Gypsum Co.*, 216 Cal. 420. If the petitioner's predecessor, instead of exercising the option on the 30th of November, 1916, had on that date sold the option to some third party, it would have realized a taxable gain which would be measured by the difference between the market value of the option on March 1, 1913 and the price for which it was sold on November 30, 1916. Because it exercised the option and thus acquired the property instead of selling the option for its market value, is it to be taxed not only for the increase in value after March 1, 1913, but for its increase between

the execution of the option in 1906 and March 1, 1913? These considerations lead to the conclusion that if the decision of the Board of Tax Appeals is to be sustained it is because under the peculiar circumstances of the case an effect is to be given to the language used by the Congress in the imposition of the income tax which not only is entirely inconsistent with the general purpose and scheme of taxation thereby imposed, but also is of doubtful constitutionality. These results are to be avoided if it can reasonably be done. Counsel for petitioner suggests two methods of avoiding this result, one by treating the purchase as having been made retroactively on the date of the option, the other, more favorable to the taxpayer, by treating the transaction of November 30, 1916 when the option was exercised, as an exchange of assets, that is, an exchange of the option and $200,000 for the land, and in determining the gains derived from subsequent sales the basis of capital investment is to be in effect the value of the land in 1916.

As to whether or not the contract of sale resulting from the exercise of the option relates back to the time of the execution of the option the authorities are not without conflict. The divergence of authorities is pointed out in the following quotation from 66 *Corpus Juris*, p. 605, § 29:

"It has been held that the acceptance of an option takes effect on the date of the acceptance and binds the party only to the conveyance of the property in its present condition, and it does not relate back to the date of the option so as to cut off intervening rights acquired with notice of the option. On the other hand, it is held that acceptance of an option and performance of the conditions entitled the holder of the option to call for a performance as of the date of giving the option (Notes 93, 94 and 95)."

It has been held in California that upon the exercise of an option, for certain purposes the contract of sale thus arising between the optioner and the optionee relates back to the time of the execution of the option. This rule was applied by the Supreme Court of California in *Smith* v. *Bangham*, 156 Cal. 359, 104 Pac. 689, where it was said in referring to the rights of the optionee who had exercised his option, "such right, when exercised, must necessarily relate back to the time of giving the option," citing, *Peoples St. Ry.* v. *Spencer*, 156 Pa. 85, 27 Atl. 113, "so as to cut off intervening rights acquired with knowledge of the existence of the option." Applying that principle the California Supreme Court enforced the rights of the option purchaser as against the rights of the wife of the seller based upon her declaration of homestead upon the property between the date of the giving of the option and of the exercise thereof.

Admitting this divergence of the authorities and assuming that it is a matter of doubt as to whether or not for all purposes the contract for a conveyance of real estate resulting from the exercise of an option by the optionee relates back to the time of giving the option, it is clear that so far as the rights of the seller and purchaser are concerned the contract resulting from the exercise

of the option does relate back to the giving of the option. It is because of the binding offer from the optioner that the optionee is entitled to purchase the property at a fixed price at the time the option is exercised. The two contracts, the giving of the option and the contract of sale resulting from its exercise, are in effect parts of a single transaction differing from a completed sale in that the optionee is entitled to refrain from entering into the contemplated agreement of sale if he so desires. From the standpoint of the income tax laws the rights of the optionee, upon the exercise of the option, should be related back to the date the option was given and the resulting contract treated as having been made on that date.

We conclude then that the optionee and lessee "acquired" the land within the meaning of the income tax laws as of the time the option was given and that the taxable gain resulting from subsequent sales of a portion of the land should be determined by deducting from the selling price the value as of March 1, 1913 of the land sold.

The conclusion we have reached as to the effect of the exercise of the option also disposes of petitioner's contention that the transaction on November 30, 1916 resulted in an exchange of capital assets and renders further discussion of that contention unnecessary.

Another question in the case is as to the proper allowance for the depreciation on the orange and walnut trees upon the property. The petitioner contends that the basis for the determination of such depreciation depends upon the proper basis to be used in determining the value of the orchard. The government does not contest this declaration and we may assume that our decision upon the only questions discussed by the respondent will be a sufficient guide to the Board of Tax Appeals for the reconsideration of the question of depreciation when presented to it.

The decision of the Board of Tax Appeals is reversed with instructions to reconsider the question before it in accordance with this opinion.

(Endorsed:) Opinion. Filed May 20, 1935. Paul P. O'Brien, clerk.

United States Circuit Court of Appeals for the Ninth Circuit

No. 7505

SAN JOAQUIN FRUIT & INVESTMENT COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Upon petition to review an order of the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this court, that the order of the said Board of Tax Appeals in this

cause be, and hereby is, reversed, and that this cause be, and hereby is, remanded to the said United States Board of Tax Appeals with instructions to reconsider the question before it in accordance with the opinion of this court.

(Endorsed:) Decree. Filed and entered May 20, 1935, Paul P. O'Brien, clerk.

United States Circuit Court of Appeals for the Ninth Circuit

No. 7505

SAN JOAQUIN FRUIT & INVESTMENT COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Certificate of Clerk U. S. Circuit Court of Appeals for the Ninth Circuit to record certified under rule 38 of the revised rules of the Supreme Court of the United States

I, Paul P. O'Brien, as clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing three hundred and forty-eight (348) pages, numbered from and including 1 to and including 348, to be a full, true, and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the respondent, and certified under rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the city of San Francisco, in the State of California, this 10th day of August, 1935.

[SEAL] PAUL P. O'BRIEN, *Clerk*.

U. S. GOVERNMENT PRINTING OFFICE: 1935

Order allowing certiorari

Filed October 14, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

O

FILE COPY

No. 379

In the Supreme Court of the United States

October Term, 1935

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner,

vs.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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10389—35

In the Supreme Court of the United States

OCTOBER TERM, 1935

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in the above-entitled cause on May 20, 1935.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 253–279) is reported in 28 B. T. A. 395. The opinion of the Circuit Court of Appeals is reported in 77 F. (2d) 723.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 20, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

A lease of real estate with option to purchase was given, and later the option was exercised. Was the property acquired, under the provisions of the Revenue Acts relating to gain or loss, when the option to purchase was given, or when the option was exercised and the property transferred?

STATUTES INVOLVED

The pertinent statutes involved will be found in the Appendix, *infra,* pp. 8–9.

STATEMENT

The facts, as found by the Board of Tax Appeals in its opinion (R. 253–279), may be summarized as follows:

On October 13, 1906, the Irvine Company leased to the San Joaquin Fruit Company 1,000 acres of bare land in Orange County, California, for ten years beginning December 1, 1906. By the terms of the lease, the lessee was required to plant fruit trees on the land and develop a water supply therefor; the lessor was to receive as rent one-fourth of the crops produced on the leased premises. The

lessee was given an option to purchase at $200 per acre not in excess of 500 acres of the land before the expiration date of the lease, or to purchase at the expiration of the lease all of the 1,000 acres at the same price per acre. An exercise of the right to purchase portions of the tract during the life of the lease worked a termination of the option to purchase all of the tract on the expiration of the term of the lease. The lessee could not assign or transfer the lease, or sublet any portion of the land, without the written consent of the lessor. The lessee developed the land as required, and on November 30, 1916, exercised the option given in the lease to purchase the 1,000 acres (R. 261–262).

In 1922, the San Joaquin Fruit Company was reorganized as the San Joaquin Fruit and Investment Company, the respondent, and all of the property was transferred to it (R. 262–264; 273–274).

During the years 1920 to 1928, respondent sold various tracts of the property. In considering respondent's tax liability for these years, the Commissioner determined that the property was acquired on November 30, 1916, when the option was exercised, and that the cost was the $200,000 paid at that time for the land, plus the amounts paid for improvements under the lease agreement, and that this cost figure was the basis for ascertaining gain or loss. The Commissioner's cost figure was not disputed (R. 275).

The Board of Tax Appeals approved the Commissioner's determination. The Circuit Court of Appeals reversed the decision of the Board, holding that the property was acquired in 1906 when the option was given, and that therefore the basis for determining gain or loss was the March 1, 1913, value of the property.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the property was acquired when the option was given, and not when the property was paid for and the title transferred.

2. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision below conflicts in principle with *Commissioner* v. *Cummings,* 77 F. (2d) 670 (C. C. A. 5th) and *Chisholm* v. *Commissioner* (C. C. A. 2d), decided July 8, 1935, not yet officially reported but found in C. C. H. 1935, Vol. 3–A, Par. 9493. These decisions hold that when property is acquired through an option, the property is not acquired or purchased until the option is exercised and the title to the property transferred. In the *Cummings* case this principle was applied in determining the date from which securities were held by the taxpayer, for purposes of the capital-gains provisions. The court there held that where stock

was purchased by exercising an option the stock was held from the date of such exercise and not from the date of the acquisition of the option. In the *Chisholm* case, which also involved options on stock, the court held that the date of exercise of the option, not the date of its acquisition or notification of intent to exercise it, constituted the date on which the sale of stock was made.

2. The decision is inconsistent with the holding of this Court in *Lucas* v. *North Texas Co.*, 281 U. S. 11, which, like the case at bar, involved an option to purchase land. In that case the taxpayer in 1916 gave an option to purchase land and was notified in the same year that the option would be exercised; the land was paid for and conveyed to the optionee in 1917. The taxpayer, although on the accrual basis, was held not entitled to attribute to 1916 the gain on the sale of the land, since not until the payment called for by the option was made did the transaction become absolute. If income cannot be attributed by the vendor to the year in which notification of acceptance of the option is given, there is even less basis for determining that the property itself was acquired by the optionee when the option was given.[1]

3. The court below relied upon a decision by the Supreme Court of California, *Smith* v. *Bangham*,

[1] In the case at bar, the uncertainty whether the land would be acquired was increased by the fact that if any portion of the land had been purchased by the optionee before 1916 the option to purchase the entire tract would have terminated, under the provisions of the lease (R. 262).

156 Cal. 359. The opinion in that case contains a statement that the rights of an optionee "relate back" to the time of acquiring the option, so that intervening rights acquired with knowledge of the option must fall when it is exercised. That doctrine has obviously no relevance to the issue of when such property is acquired within the meaning of the revenue acts. The equitable doctrine of "relation back" cannot obscure the fact that when an option is given the optionee has merely the privilege of accepting, by payment, a continuing offer of sale. Until such acceptance the optionee has been held, in various situations, to have no interest or estate in the land. *Richardson* v. *Hardwick,* 106 U. S. 252 (specific performance); *Todd* v. *Citizens Gas Co.,* 46 F. (2d) 855 (C. C. A. 7th), certiorari denied 283 U. S. 852 (rule against perpetuities); *Phenix Insurance Co.* v. *Kerr,* 129 Fed. 723 (C. C. A. 8th) (insurable interest). The option "merely pointed out the mode in which he [the optionee] might acquire an interest, namely, by paying a certain sum of money within a certain time." *Richardson* v. *Hardwick, supra,* at 254.

4. The question presented is important because of the large number of transactions in which options are used, particularly in connection with real estate and securities. The doctrine of "relation back", as it has been applied herein, introduces a novel and fictitious element into the law of income

taxation and will create confusion in numerous tax cases involving the exercise of options.

Wherefore, it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

AUGUST 1935.

APPENDIX

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060:

BASIS FOR DETERMINING GAIN OR LOSS.

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *.

* * * * *

Revenue Act of 1921, c. 136, 42 Stat. 227, 229:

BASIS FOR DETERMINING GAIN OR LOSS

SEC. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; * * *.

* * * * *

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

* * * * *

Revenue Act of 1924, c. 234, 43 Stat. 253:

BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION

SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * * or (B) the fair market value of such property as of March 1, 1913, whichever is greater. * * *

* * * * *

(U. S. C., Title 26, Sec. 935).

U. S. GOVERNMENT PRINTING OFFICE: 1938

FILE COPY

Office Supreme Court,
FILED
DEC 31 193
CHARLES ELMORE

No. 379

In the Supreme Court of the United States

OCTOBER TERM, 1935

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

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Miscellaneous:	
James, *Option Contracts*, Sec. 501	10, 18

In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 379

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 253–279) is reported in 28 B. T. A. 395. The opinion of the Circuit Court of Appeals (R. 338–344) is reported in 77 F. (2d) 723.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 20, 1935. (R. 344.) Petition for certiorari was filed August 19, 1935, and was granted October 14, 1935. The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

A lease of real estate with option to purchase was given prior to March 1, 1913, and the option was exercised after March 1, 1913. Was the property acquired, within the meaning of the Revenue Acts relating to gain or loss, when the option to purchase was given, or when the option was exercised and the property transferred?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1921, c. 136, 42 Stat. 227, 229:

BASIS FOR DETERMINING GAIN OR LOSS

SEC. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property;

* * * * * *

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

* * * * * *

Revenue Act of 1924, c. 234, 43 Stat. 253, 258:

BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION

SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(*b*) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * * or (B) the fair market value of such property as of March 1, 1913, whichever is greater. * * *.

Revenue Act of 1926, c. 27, 44 Stat. 9, 14:

Section 204 (a) and (b) of the Revenue Act of 1926, so far as material, is identical with the quoted provisions of the Revenue Act of 1924.

Revenue Act of 1928, c. 852, 45 Stat. 791, 818:

Section 113 (a) and (b) of the Revenue Act of 1928, so far as material, is identical with Section 204 (a) and (b) of the Revenue Act of 1926.

STATEMENT

The facts, as found by the Board of Tax Appeals in its opinion (R. 253–279), may be summarized as follows:

On October 13, 1906, the Irvine Company leased to the San Joaquin Fruit Company 1,000 acres of bare land in Orange County, California, for ten

years beginning December 1, 1906. By the terms of the lease, the lessee was required to plant fruit trees on the land and develop a water supply therefor; the lessor was to receive as rent one-fourth of the crops produced on the leased premises. The lessee was given an option to purchase at $200 per acre, not in excess of 500 acres of the land before the expiration date of the lease, or to purchase at the expiration of the lease all of the 1,000 acres at the same price per acre. An exercise of the right to purchase portions of the tract during the life of the lease worked a termination of the option to purchase all of the tract on the expiration of the term of the lease. The lessee could not assign or transfer the lease, or sublet any portion of the land, without the written consent of the lessor. The lessee developed the land as required, and on November 30, 1916, exercised the option given in the lease to purchase the 1,000 acres, and at that time the consideration was paid and the deeds delivered. (R. 261–262.)

In 1922, the San Joaquin Fruit Company was reorganized as the San Joaquin Fruit and Investment Company, the respondent, and all of the property was transferred to it. (R. 262–264; 273–274.)

During the years 1922 and 1924 to 1928, respondent sold various tracts of the property. (R. 260.)[1]

[1] As stated by the court below, a determination of the basis for computing gain on sales will also establish the basis for 1920 to 1922, inclusive, and 1924 to 1928, inclusive. (R. 344, 255 260.)

depreciation on walnut and orange trees during the years

In considering respondent's tax liability for all the years, the Commissioner determined that the property was acquired on November 30, 1916, when the option was exercised and the property purchased, and that the cost was the $200,000 paid at that time for the land, plus the amounts paid for improvements under the lease agreement, and that this cost figure was the basis for ascertaining gain or loss (R. 264, 132, 174.) The Commissioner's cost figure was not disputed. (R. 275.)

The Board of Tax Appeals approved the Commissioner's determination. (R. 268.) The Circuit Court of Appeals reversed the decision of the Board (R. 344), holding that the property was acquired in 1906 when the option was given, and that therefore the basis for determining gain or loss was the March 1, 1913, value of the property.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the property was acquired when the option was given, and not when the property was paid for and the title transferred.

2. In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

The statutes provide that the basis for determining gain or loss on a sale of property shall be the cost thereof if *acquired* after February 28, 1913, and if *acquired* prior to March 1, 1913, the basis is the value of the property on that date. Here the

property sold by the taxpayer during the taxable years was purchased in 1916 upon the exercise of an option obtained in 1906. The taxpayer in 1906 leased the property for ten years, with an option to purchase at the end of the term, and made substantial improvements thereto.

Inasmuch as the option was not exercised until 1916, the taxpayer then, for the first time, became the owner of the property and on that date the taxpayer *acquired* the property. Prior to the exercise of the option the taxpayer had no estate or interest, legal or equitable, in the property other than as lessee. The option vested no estate in the taxpayer, but was a mere right to buy should it so elect. There is here no foundation for relating the title and estate acquired upon exercise of the option back to the date of the option. The doctrine of relation back is invoked only to protect the rights of the optionee against intervening rights acquired with notice of the option.

Treatment of the gain actually received by the taxpayer as income to it does not result in imposing tax on gains accrued to this taxpayer prior to March 1, 1913. There is no question here of the constitutional power of Congress to tax gains accruing prior to March 1, 1913, and taxation of the actual gain here realized does not contravene the intent of Congress to exclude from income gains accruing prior to March 1, 1913. Any gain which may have accrued on this property prior to March 1, 1913, did not accrue to this taxpayer as

it was not its property then or at any time prior to 1916. The gain resulting from increased value of property is income when realized to the actual recipient thereof whether or not the increase occurred entirely while the property was held by the particular taxpayer. The mere fact that the taxpayer was in the fortunate position of making large profits on sales of the property in no wise justifies exempting any portion of the gain from taxation, through the medium of treating the property as acquired at the date of the option and thereby increasing the basis contrary to the provisions of the statutes.

The decision below is erroneous and should be reversed.

ARGUMENT

Each of the applicable Revenue Acts (1921 to 1928), so far as here material, provides in substance that the basis for determining the gain from the sale or other disposition of property shall be the cost thereof if *acquired* after February 28, 1913, and shall be the cost or March 1, 1913, value thereof, whichever is greater, if *acquired* prior to March 1, 1913. Here there is no dispute as to the amounts received from the sales of property during the taxable years, nor is the actual amount paid for the property by the taxpayer in dispute. We are concerned only with the proper *basis* under the statutes upon which to determine the taxable gain derived. Thus the only question here involved is whether the property was *acquired* be-

fore or after March 1, 1913. The Commissioner contends that the property was not acquired by this taxpayer until 1916, when the option to buy was exercised and that prior to that time the taxpayer had no ownership, estate or interest in the property in question (except its estate as lessee), but only an option to purchase or a mere *right to acquire* the property.[2] The Circuit Court of Appeals, however, held that the taxpayer (R. 344)—

> "acquired" the land within the meaning of the income tax laws as of the time the option was given, and that the taxable gain resulting from subsequent sales of a portion of the land should be determined by deducting from the selling price the value as of March 1, 1913 of the land sold.

In so holding, we submit, the Circuit Court of Appeals clearly erred.

The distinguishing characteristic of an option contract is that it imposes no binding obligation upon the person holding the option, and such a

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[2] The respondent is the successor to the San Joaquin Fruit Company, which secured the option, and that company was reorganized in 1922 under the name of the respondent. All the property of the predecessor corporation was transferred to the respondent. It is now settled that the respondent is liable, as transferee, for any unpaid taxes due from its predecessor (52 F. (2d) 123) and that the property having been received by the respondent in a nontaxable transaction, the basis for determining the gain or loss from sales by the respondent is the same as it would have been in the hands of its predecessor (R. 339). Accordingly, for the purposes of this case we refer to the respondent and its predecessor generally as the "taxpayer."

contract is not to be confused with an agreement of sale binding upon both parties thereto and conferring mutual rights and interests in the property the subject of the agreement. An option is nothing more than a contract by which the owner of property agrees that another shall have *a right to buy the property at a stipulated price and upon agreed terms,* usually within a stated time. It has been recognized by the weight of authority for many years that an option to purchase property, whether it be a covenant in a lease of realty or a separate contract, does not convey and vest in the optionee any estate, title or interest, legal or equitable, in the property, and that this is a necessary consequence of the nature of the contract. The optionor does not sell the property but merely sells the right to buy if the optionee so chooses. *Willard* v. *Tayloe,* 8 Wall. 557, 564; *Richardson* v. *Hardwick,* 106 U. S. 252, 254; *Phenix Ins. Co.* v. *Kerr,* 129 Fed. 723 (C. C. A. 8th); *Todd* v. *Citizens' Gas Co. of Indianapolis,* 46 F. (2d) 855, 866 (C. C. A. 7th), certiorari denied, 283 U. S. 852; *Kadish* v. *Lyon,* 229 Ill. 35, 40, 82 N. E. 194; *Luigart* v. *Lexington Turf Club,* 130 Ky. 473, 480, 113 S. W. 814; *Gamble* v. *Garlock,* 116 Minn. 59, 133 N. W. 175; *Trumbull* v. *Bombard,* 171 App. Div. 700, 157 N. Y. S. 794; *Caldwell* v. *Frazier,* 65 Kan. 24, 68 Pac. 1076; *Bras* v. *Sheffield,* 49 Kan. 702, 710, 31 Pac. 306. The principle is recognized and applied in California as well as in other jurisdictions. *Smith* v. *Bangham,* 156 Cal. 359, 104 Pac. 689; *Hicks* v. *Christeson,* 174 Cal. 712, 164 Pac.

395; *Ludy* v. *Zumwalt,* 85 Cal. App. 119, 259 Pac. 52; *Menzel* v. *Primm,* 6 Cal. App. 204, 91 Pac. 754. See also, James on Option Contracts, Sec. 501 *et seq.*

In *Willard* v. *Tayloe, supra,* the lessees of real estate for a term of ten years, with an option to purchase, exercised the option and specific performance was decreed. Upon exercise of the option there arose a binding *contract of sale,* whereas prior thereto the lessee-optionee had only a *right to buy.* The Court said (p. 564):

> The covenant in the lease giving the right or option to purchase the premises was in the nature of a *continuing offer to sell.* * * * *When accepted* * * * *a contract of sale* between the parties was completed. (Italics supplied.)

Richardson v. *Hardwick, supra,* involved an option to purchase a half interest in lands, which was not exercised within the time specified. This Court said (p. 254):

> The written contract gives him [the optionee] the privilege, or, as counsel call it, an "option", to become equally interested in the lands by paying one-half the purchase-money, &c., within two years after its date. *The contract, of itself, did not vest him with any interest or estate in the lands. It merely pointed out the mode in which he might acquire an interest,* namely, by paying a certain sum of money within a certain time." (Italics supplied.)

In *Phenix Ins. Co.* v. *Kerr, supra,* an action to recover under a policy of insurance upon property as to which there had been given a lease with an option to purchase, it was held that the optionor was the unconditional owner of the property and entitled to the insurance proceeds. The court said (p. 727):

> And while the owner of the option may accept it, and compel the owner of the property to comply with its terms, until the owner of the option does so he has no interest in the property. He has nothing but a mere right to acquire an interest, and this is neither the ownership nor any interest in the property which impinges upon its unconditional ownership by him who gave the option.

In *Todd* v. *Citizens' Gas Co. of Indianapolis, supra,* it was said (p. 866):

> By the great weight of authority, a mere option to purchase land does not vest the holder of an option with any interest, legal or equitable, in the land.

And the principle is the same whether the option be a separate contract or contained in a lease. The mere fact that a lessee is in possession of real estate under a lease with an option to purchase, which is a covenant running with the land, and has made improvements upon the leased premises, does not vest in him under the option any estate or interest in the land. Any estate which he holds is merely the leasehold interest under the lease. In *Kadish*

v. *Lyon, supra,* the contention that a lessee, with an option to purchase, who had made improvements upon the premises, was in equity the owner of the fee, was rejected. The court said (p. 40):

> We think this [the contention] ignores the distinction between a contract for the purchase of real estate and a contract by which the owner gives to another the option to purchase lands. Kadish [the lessee] and those who succeeded him would acquire no interest in the land by virtue of this contract for an option until he or they had exercised their right to purchase. * * * The provision that the agreement to sell should be a covenant running with the land does not alter the situation.

In *Bras* v. *Skeffield, supra,* the lessee of property for a five year term, with an option to purchase, had entered into possession and cultivated the land. It was held that the contract for an option was not a sale and did not vest in the optionee any title or interest beyond what was acquired under the lease. *Caldwell* v. *Frazier, supra,* was an action of ejectment by the lessor against lessees who had taken possession of the property there involved under a lease, with an option to purchase. The lease having expired and the buildings having been destroyed by fire, the lessees had sought to exercise the option claiming that the property should be restored to its original condition or that the insurance proceeds should be applied to the agreed purchase price. The court said in answer to the

lessees' prayer for either specific performance of the contract or damages for its breach (pp. 27, 28):

> This court is of the opinion that under the facts a specific performance could not be decreed, and that plaintiffs in error [optionees] were not entitled to recover damages as for a breach of contract.
>
> *An option contract conveys no estate or interest in the property. It is but a continuing offer to sell, which may be accepted by the holder thereof, prior to a time usually fixed in the contract, and,* like other contracts *when accepted, takes effect from the date of its acceptance and not from the date of the offer.*
>
> * * * in an option contract to purchase the obligee takes no interest, the contract is incompleted, it lacks mutuality until acceptance, *and when accepted it does not relate back to the date of the offer,* * * *. (Italics supplied.)

To the same effect are *Luigart* v. *Lexington Turf Club, supra; Gamble* v. *Garlock, supra; Trumbull* v. *Bombard, supra; Hicks* v. *Christeson, supra; Ludy* v. *Zumwalt ,supra.*

The court below ignored the essential and fundamental nature of an option to buy which we have pointed out above and discarded the principle that an option contract conveys no estate or interest in the property and when accepted takes effect from the date of its acceptance and not from the date the option was given, though this principle is recognized in California as well as by the great weight of

authority in other jurisdictions. The court below said that under the law of California the option in this case gave the taxpayer such a right as will be protected in equity, and in support thereof cited *Gordon* v. *Dufresne,* 205 Cal. 512, and *Chapman* v. *Great Western Gypsum Co.,* 216 Cal. 420. Whether the taxpayer, as optionee, had a right which equity would protect is wholly beside the point here. The question here is whether the taxpayer had such an estate or interest in the property, prior to the exercise of the option, that it may be said it *acquired the property* at the time the option was given or prior to the exercise of the option. If the statement of the court below is taken to mean that the taxpayer, prior to the exercise of the option, was the equitable owner of the property or had an equitable estate or interest therein merely by virtue of the option, we submit that such a holding clearly is erroneous and the cases relied upon do not support such a view.

The *Gordon* v. *Dufresne* case was an action for specific performance of an option to purchase given in a lease of property. Within the time limited the lessee-optionee exercised the option, tendered the agreed purchase price and demanded a deed to the property, which was refused. The trial court held that the option agreement was without consideration and void. The Supreme Court of the State, in reversing the lower court and decreeing specific performance, held merely that the option agreement and the lease were not divisible, but formed

one document, and the covenant to pay rent and perform other acts supported the option as well as the right to occupy the premises. The decision is predicated solely on the ground that the option contained in the lease is supported by consideration, is valid, and when accepted according to its terms is enforceable. There is nothing in the decision in anywise tending to support a contention that the holder of an option to purchase property, whether or not contained in a lease, vests any estate or interest, legal or equitable, in the optionee prior to the exercise of the option.

In *Chapman* v. *Great Western Gypsum Co., supra,* the problem presented was, as stated by the court (p. 424):

> An owner of a lease containing an option to purchase the fee, mortgages the same to secure a debt. Thereafter the lessee-mortgagor assigns the lease to a third party who has full knowledge of the mortgage. The third party exercises the option and secures a conveyance of the fee. The ultimate legal question to be determined is whether or not under such circumstances the lien of the mortgage attaches to the fee in the hands of the third party or those who take with notice, from the third party.

The court expressly refrained (p. 425) from deciding whether the holder of a mere option to purchase real property acquires an interest therein and held only that, as the option contained in the lease

of real property was a covenant real running with the land and the mortgage of the lease included the option, the assignee of the lease and option took subject to the mortgage and *upon exercise of the option* by the assignee the lien of the mortgage attached to the fee. The decision apparently rests solely upon the ground that the assignee had actual knowledge of the mortgage lien and that the mortgage lien on the option could not be defeated through exercise of the option by the assignee with notice, any more than the original holder of the option could have defeated the lien by exercising the option (p. 433). That such is the basis of the decision appears also from the discussion therein of *Ludy* v. *Zumwalt, supra,* which held that an option is not such an interest in land that a recorded lien thereon is constructive notice and that the lien on the interest of the optionee who subsequently exercised the option, acquiring the fee, is inferior to the lien of the purchase-money mortgage given upon exercise of the option. The latter case was distinguished on the grounds, among others, that in the *Chapman* case there was *actual* knowledge of the mortgage lien and the controversy was between the optionee and the lienholder, whereas in the *Zumwalt* case constructive notice of the lien was asserted and the controversy was between the optionor and the lienholder. We submit that the *Chapman* case is not authority for the view that the holder of an option to purchase real property

owns an equitable interest in the property prior to the exercise of the option.

It may well be that the holder of a valid option to buy real property, supported by a valuable consideration, has rights which equity will protect by such means as requiring specific performance where the option is timely exercised according to its terms and preserving his contractual rights against subsequent purchasers with notice of the option. But such equitable rights and remedies are not founded upon any estate or interest of the optionee in the property. They arise from his rights under the option contract which gives him the ***right to buy*** and is binding on the optionor, and all who take under him with notice, when the optionee elects to exercise his right. That, manifestly, is a matter quite distinct from the question whether the option vests in the optionee any estate or interest in the property prior to exercise of the option. As we have shown, the latter question is answered in the negative.

The court below further said, in an effort to support its conclusion, that from the standpoint of the revenue laws the rights of the optionee, upon exercise of the option, should be *related back* to the date of the option and the resulting contract of sale treated as made on that date, and in support thereof cited *Smith* v. *Bangham, supra.* In that case it was held that the holder of a valid option to buy real property, upon the timely exercise of the option,

was entitled to specific performance notwithstanding the declaration of homestead by the optionor's wife made after the option contract and with actual knowledge thereof. The court held merely that the *right of the optionee to specific performance,* when exercised, necessarily related back to the date of the option *so as to cut off intervening rights acquired with knowledge of the existence of the option.* The case does not hold that an option vests an estate or interest, legal or equitable, in the optionee prior to its exercise or that upon exercise of the option the title, estate or interest then acquired relates back to the date of the option for all purposes. Indeed the court recognizes the prevailing rule that no estate or interest in the property vests by virtue of the option. The decision rests solely upon the ground that a subsequent purchaser of property with knowledge of the existence of a valid option thereon takes subject to the right of the option holder to accept the optionor's offer to sell (p. 365). And that seems to be the basis of those decisions which *appear* to hold contrary to the rule established by the weight of authority. See James on Option Contracts, Sec. 501. There are no such considerations in this case warranting the application of the doctrine of relation back. The doctrine is a mere fiction, used only to prevent patent injustice, and is generally applied to protect the optionee against intervening purchasers with notice of the rights of the optionee. When no such un-

usual circumstances exist the basis for the doctrine is removed and title to the property does not relate back. See *Lady* v. *Zumwalt, supra* (p. 129). In the absence of such circumstances, upon the exercise of the option the title and estate in the property vest at that time and the optionee takes the property in its then condition. See *Caldwell* v. *Frazier, supra.* We submit there is wholly lacking any circumstance in the present case justifying application of the doctrine of relation back. No injustice here is done by applying the usual and recognized principle that the property vests, is acquired, only when the option is exercised.

Moreover, it is submitted that this doctrine, which is sometimes applied in equity for the limited purpose noted, has no proper application in the construction and administration of the income tax laws. *Coyle* v. *Commissioner,* 17 B. T. A. 368; *City Bank Co.* v. *Commissioner,* 1 B. T. A. 210. In the *Coyle* case, the contention that the optionee who purchased an oil lease should be considered the owner of the property from the date of the option was rejected. The Board there said (pp. 379–380):

> Whatever may be the merits of this fiction when applied to the devolution of estates, it can find little, if any, place in income-tax law. Our various revenue acts make the taxable year, whether calendar or fiscal, the period for which all income must be returned and taxed. Except for the net loss provisions in the various revenue acts, the net in-

> come for the taxable year is dependent on what occurred in that year. While it is true income and losses may be accrued by one who keeps his books on that basis, yet such accruals must be based on what actually occurred in the taxable year. If we admit the fiction here asserted by respondent, we will find one returning and properly returning as rent what he received from a lease and years afterwards we will find the same person compelled to return such rentals as purchase money received. The contract we have before us runs through two taxable years and it would be quite peculiar to hold that petitioners were the owners of the lease during December, 1921, but that they were not owners of the lease from that time on to the time of execution of the option. The contention made by respondent is based entirely upon a fiction. Tax laws deal with realities. Taxes "are not laid upon abstractions." *Edwards* v. *Slocum,* 287 Fed. 651, affd., 264 U. S. 61. We find no merit in this contention.

The *City Bank Co.* case involved a purchase of land by the mortgagee under a judicial sale decreed in September, 1912. The sale made pursuant to the order or decree was not confirmed and the deed was not delivered until March 24, 1913. Holding that the land was *acquired,* within the meaning of the revenue Act, after March 1, 1913, the Board said (pp. 212–213):

> There is another rule of law with respect to judicial sales to the effect that upon con-

firmation thereof the deed executed pursuant thereto takes effect by relation as of the day of sale, and vests in the purchaser the right to intermediate rents (16 Ruling Case Law, 132; *Jashenosky* v. *Volrath,* 59 Oh. St. 540).

The taxpayer having title by relation as of February 28, 1913, the day of sale, the question is, does title by relation meet the requirements of the statute that the property must have been *acquired* before March 1, 1913, in order that the fair market price or value as of that date may be used as the basis for determining gain or loss on the subsequent sales. The word *acquired* was undoubtedly used in the statute in its ordinary sense of "obtained as one's own" and we think it should be applied in that sense. On March 1, 1913, the taxpayer had no title and could have none until the sale was confirmed by the court. Upon confirmation and the execution and delivery of the deed it had title by relation as of February 28, 1913, but we do not think title by relation as of a particular date is equivalent to having acquired the property on that date. The property was not "obtained as its own" prior to March 1, 1913, but only from the date of confirmation, and the fact that upon confirmation the title relates back to the sale does not meet the challenge of the statute.

The principle that an option to buy property confers or vests no estate or interest in the property prior to exercise of the option, is equally well recog-

nized in applying the revenue acts as in other fields of law. In *Lucas* v. *North Texas Co.*, 281 U. S. 11, the taxpayer in 1916 gave an option to purchase certain land, and was notified in the same year that the option would be exercised. The transaction was not completed until 1917, when payment was made and the land conveyed. This Court said (p. 13):

> An executory contract of sale was created by the option and notice, December 30, 1916. In the notice the purchaser declared itself ready to close the transaction and pay the purchase price "as soon as the papers were prepared." Respondent did not prepare the papers necessary to effect the transfer or make tender of title or possession or demand the purchase price in 1916. The title and right of possession remained in it until the transaction was closed. Consequently unconditional liability of vendee for the purchase price was not created in that year.

It was held that the profit on the sale was income in the year 1917. If the profit on the sale of land under an exercised option to buy is not income to the vendor until the transaction is completed, it would seem, conversely, that the vendee does not acquire the land or any interest therein at least until the option is exercised.

In *Commissioner* v. *Cummings*, 77 F. (2d) 670 (C. C. A. 5th), the taxpayer exercised his option to buy certain stock and claimed that the gain on a

sale of the stock should be taxed at capital gain rates, since the option was acquired more than two years prior to the sale, although the stock itself was acquired less than two years before the sale. The statute defined capital assets, on the sale of which gains are allowed a special tax rate, as property held for more than two years. The court held that the stock was held only from the date the option was exercised and not from the date the option was acquired. It was said (pp. 672–673):

> The shares thus acquired came to the taxpayer as new property. * * * They may not be considered as standing for the options upon the exercise of which they were purchased, and therefore as held for more than two years prior to their exchange and sale.

In *Chisholm* v. *Commissioner,* 79 F. (2d) 14 (C. C. A. 2d),[3] the taxpayer and his brother, owning certain stock, gave to another an option to buy, to be exercised by payment of cash within the time specified. Prior to due exercise of the option, but after notice that it would be taken up, the brothers formed a partnership and transferred the stock to it. The option was exercised and sale completed.

[3] The Government filed with this Court a petition for certiorari, No. 519, to review that case, which was denied November 11, 1935. The contention there urged by the Government was that under the particular circumstances presented the gain derived from the sale of the stock was taxable income to the individuals because the sale in reality was made by the individuals, the firm acting merely as their agent.

In holding that the sale was made by the partnership, not by the individuals, and that the sale was not made until the option was exercised, the court said (p. 15)—

> the option was an offer to sell, not to contract to sell; it required payment, not a promise to pay, and the notice, not corresponding with the offer, was legally a nullity. The sellers became bound only * * * when Krauss & Co.'s assignees paid the price.

Underlying each of these cases is the principle that the holder of an option to buy, prior to the exercise thereof, acquires no title or interest or estate in the property itself. On that basis the *North Texas Co.* case held that full ownership of the land remained in the vendor until 1917 and hence the gain was taxable income for that year, and not for 1916 when the option was given, although notice of acceptance was given by the optionee in 1916. Similarly, the *Cummings* case ruled that the property sold had not been held for more than two years, because it was not *acquired* until the option to buy was exercised. Likewise, the *Chisholm* case held that the stock was sold and passed to the optionee-purchaser from the partnership and not from the partners as individuals, because the option was not exercised until after the stock had been transferred to the firm.

In the instant case the taxpayer in 1906 took a lease upon the real estate in question, whereby it

was given the option to buy the property at an agreed price, *upon termination of the lease.* Pursuant to the lease the taxpayer proceeded to improve the property and spent substantial amounts in so doing. *Upon termination of the lease,* the taxpayer exercised the option, paid the agreed price and received the title in fee.

In the light of what has been said above, we think it plain that the taxpayer did not *acquire* the property here involved until 1916, when the option was exercised. Prior to that time it had only a right to buy and owned no interest or estate in the property, other than the term for years under the lease. Indeed, even if it might be assumed that the taxpayer prior to exercise of the option had some estate or interest in the property, such interest certainly was of no greater dignity than a contingent—as contrasted with a vested—estate. It is quite generally recognized that the holder of a contingent estate in property does not acquire the same within the meaning of the revenue acts until the estate becomes vested. See *Hopkins* v. *Commissioner,* 69 F. (2d) 11 (C. C. A. 7th); *Roebling* v. *Commissioner,* 78 F. (2d) 444 (C. C. A. 3d); *Warner* v. *Commissioner,* 72 F. (2d) 225 (C. C. A. 2d); *Pringle* v. *Commissioner,* 64 F. (2d) 863 (C .C. A. 9th), and *Lane* v. *Corwin,* 63 F. (2d) 767 (C. C. A. 2d). Cf. also, *Brewster* v. *Gage,* 280 U. S. 327. In this case no interest in the property vested in the taxpayer at the time the option was

given or at any time prior to the exercise of the option. The optionor here did not hold the property prior to the exercise of the option for the benefit of the taxpayer, as the executor in the *Brewster* case was said to have held the decedent's estate for the benefit of the legatees, heirs, and devisees and not in his own right and behalf. Prior to exercise of the option unconditional ownership of the property was in the optionor, who held in its own right and for its own benefit.

The court below felt that, as Congress did not intend to tax gains accruing prior to March 1, 1913, and to avoid grave doubts as to the constitutional power of Congress to tax such gains, it was necessary to treat the property as having been acquired when the option was obtained. We submit that there is no occasion to consider here the general question of the constitutional power of Congress to tax gains accrued prior to the adoption of the Sixteenth Amendment. While it may be true that the amount realized by the taxpayer embraces, and resulted in large part from, the enhancement in value of the property during the years prior to 1913, the fact remains that the gain accruing through such enhancement did not accrue to property owned by this taxpayer. The land and the gain accruing thereto prior to March 1, 1913, did not become the property of this taxpayer until the option was exercised in 1916. The revenue acts do not purport to

tax as gains mere accretions to the value of property which have not been severed from the capital investment therein, but it is equally plain that the statutes do tax such gains when they are severed as income of the year in which severed and received. The amount received by the taxpayer in excess of the cost of the property to it is the actual gain derived and the tax thereon places no unjust burden upon it merely because the amount of the gain may be large. It can not now be contended that gain actually resulting from the increased value of capital can be treated as taxable income in the hands of the recipient only so far as the increase occurred while he owned the property. *Taft* v. *Bowers,* 278 U. S. 470. We submit that the decision below in effect sustains the contention which this Court said in the *Taft* case finds no support in the Constitution.

It seems clear that the taxpayer acquired the property here in question in 1916, when the option was exercised, and the purchase price was paid according to its terms, and the property was delivered to it. It follows necessarily that under the statutes the basis for determining the taxable gain on sales of the property is the cost thereof to the taxpayer, and the Circuit Court of Appeals erred in holding that the proper basis is the March 1, 1913, value of the property.

CONCLUSION

The decision of the Circuit Court of Appeals is erroneous and should be reversed.

Respectfully submitted.

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DECEMBER 1935.

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No. 379.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR SAN JOAQUIN FRUIT & INVESTMENT COMPANY IN OPPOSITION.

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IN THE

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GUY T. HELVERING, Commissioner of Internal Revenue,
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SAN JOAQUIN FRUIT & INVESTMENT COMPANY.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR SAN JOAQUIN FRUIT & INVESTMENT COMPANY IN OPPOSITION.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 253-279) is reported in 28 B. T. A. 395. The opinion of the Circuit Court of Appeals is reported in 77 Fed. (2d) 723.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered May 20, 1935 (R. 344). The petition for certiorari was filed on August 19, 1935. The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

A lease of real estate with option to purchase was obtained by the respondent in 1906 and the option was exercised in 1916. A portion of the property was sold within the taxable years here involved. Was the property "acquired", under the provisions of the Revenue Acts relating to gain or loss, when the option was given, so that the respondent's basis is the value as at March 1, 1913, or was it "acquired" when the option was exercised in 1916, so that the respondent's basis is limited to the amount paid under the terms of the option agreement?

Statutes Involved.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060:

Basis for determining gain or loss.

Sec. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *.

* * * * * * * * * *

Revenue Act of 1921, c. 136, 42 Stat. 227, 229:

Basis for determining gain or loss.

Sec. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; * * *.

* * * * * * * * * *

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of

property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

* * * * * * * * *

Revenue Act of 1924, c. 234, 43 Stat. 253, 258:

Basis for determining gain or loss, depletion, and depreciation.

Sec. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *.

* * * * * * * * *

(b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * * or (B) the fair market value of such property as of March 1, 1913, whichever is greater. * * *

* * * * * * * * *

Statement.

The facts as found by the Board of Tax Appeals (R. 253-279), and as established by the evidence, are summarized as follows:

On October 13, 1906, the Irvine Company leased to the San Joaquin Fruit Company 1,000 acres of bare land in Orange County, California, for ten years, beginning December 1, 1906 (R. 261). By the terms of the lease the lessee was required to plant fruit trees on the land and develop a water supply therefor (R. 261). The lessor was to receive as rent one-fourth of the crops produced on the

leased premises (R. 262). The lessee was given an option to purchase at $200 per acre not in excess of 500 acres of the land before the expiration date of the lease, or to purchase at the expiration of the lease all of the 1,000 acres at the same price per acre; and exercise of the right to purchase portions of the tract during the life of the lease worked a termination of the option to purchase all of the tract on the expiration of the term of the lease (R. 262). The lessee could not assign or transfer the lease or sublet any portion of the land without the written consent of the lessor (R. 262). When the ten-year lease-option was entered into in 1906 the 1,000 acres of land was uncleared desert overgrown with sage brush and cactus (R. 340). The success of the project depended upon obtaining and developing an underground supply of water for irrigation (R. 340, 315, 310). The 1,000 acres required 250 miner's inches of water (R. 311, 315). Within two years, or by the end of 1908—*i. e.*, long before March 1, 1913—the *optionee* sank several wells to depths ranging from 50 to 400 feet and developed an ample and continuous steady supply of water (R. 262, 315, 340). By the end of the year 1909 the optionee had set out 390 acres to orange trees and 600 acres to walnut trees (R. 262), and by the end of the year 1910 the optionee had expended from $150,000 to $170,000 in developing and improving the tract (R. 262, 340). On March 1, 1913, the tract had a value of $1,635,000, and the option to purchase at $200,000 had a value on March 1, 1913, of $1,360,000 (R. 340). At the end of the ten years, that is, on November 30, 1916, the tract had a value of $2,150,000 (R. 340). The optionee was continuously in possession of the tract from the beginning in 1906, and the greatly increased value by March 1, 1913, was a value essentially *created* by the optionee through creative and constructive industry (R. 315-317), to be owned and held permanently as its own, subject only to payment of the purchase price of $200,000. On November 30, 1916, the optionee exercised

the option given in the lease to purchase the 1,000 acres (R. 262, 318).

In 1922, the San Joaquin Fruit Company was reorganized as the San Joaquin Fruit and Investment Company, the respondent, and all of the property was transferred to it (R. 262-264; 273-274).

During the years 1920 to 1928, respondent sold various tracts of the property. In considering respondent's tax liability for these years, the Commissioner determined that the property was acquired on November 30, 1916, when the option was exercised, and that the cost was the $200,000 paid at that time for the land, plus the amounts paid for improvements under the lease agreement, and that this cost figure was the basis for ascertaining gain or loss. The Commissioner's cost figure was not disputed (R. 275).

The Board of Tax Appeals approved the Commissioner's determination. The Circuit Court of Appeals reversed the decision of the Board, holding that the property was acquired in 1906 when the option was given, and that therefore the basis for determining gain or loss was the March 1, 1913, value of the property.

Reasons Against Granting the Writ.

1. The petitioner seeks to show that the decision of the court below is in conflict with *Commissioner* v. *Cummings*, 77 Fed. (2d) 670 (C. C. A. 5), and *Chisholm* v. *Commissioner* (C. C. A. 2), C. C. H. 1935, Vol. 3-A, Par. 9493, Prentice-Hall 1935, Par. 1617; but an examination shows that there is no real conflict. The subject matter in those cases was entirely different and they were simply cases of a bare option to purchase shares of stock, held by an optionee out of possession, who was not in enjoyment of the fruits of the property, and who could not possibly have any property interest whatever in the shares unless and until the option was exercised and the purchase money paid. Moreover, neither of those cases dealt with the question whether an

interest in property had been acquired before March 1, 1913. The facts of those cases differ so widely and completely from this case that there is no possibility of conflict of decisions.

2. The decision below is not inconsistent with *Lucas* v. *North Texas Lumber Company,* 281 U. S. 11, but is supported by it. The subject matter of that case was an executory contract of sales of Texas timberland; the decision turned upon rules relating to title, right of possession, and liability for purchase price, and was based upon the local rule or decision in the cited case of *Gober* v. *Hart,* 36 Tex. 139. The option was a bare option, without more, held by an optionee not in possession. At bar, the option covenant was contained in a lease, and the lease and option were indivisible and interdependent; the consideration went to the whole, and thereby rendered the option irrevocable, *Gordon* v. *Dufresne,* 205 Cal. 512. An option covenant *contained in a lease of land* is a covenant real, *i. e., real property,* and is sharply to be distinguished from an option unconnected with an interest in property such as a lease, *Chapman* v. *Great Western Gypsum Company,* 216 Cal. 420. Furthermore, an optionee in possession of land, who during possession expends some thousands of dollars in improving the land, has an actual interest in the land—an interest real—*Crowell* v. *Ewing,* 4 Cal. App. 358. In the case at bar, the lessee-optionee, in beneficial possession, expended $150,000 to $170,000 in capital improvements of the land before March 1, 1913. The statutory language is "property acquired before March 1, 1913," and the word "property" as used in the Revenue Acts is not used in a restricted sense, nor with any narrow or technical meaning, but has a broad meaning, *Lynch* v. *Alworth-Stephens Company,* 267 U. S. 364, 369; *Commissioner* v. *Stephenson-Adamson Mfg. Company,* 51 Fed. (2d) 681, 682. One may have an interest real, that is, an interest in land, without having a title, an interest in land being a right less than title, *Brown* v. *Sweet,* 95 Cal. App. 117, and it is

unnecessary to the ownership of an interest in real property that the owner be able to give it an historical or conventional name or put it into any particular pigeonhole of the law of real property, *Estate of Pitts,* 218 Cal. 184. The test would appear to be whether the respondent had acquired a "valuable economic interest" on or prior to March 1, 1913, *Palmer* v. *Bender,* 287 U. S. 551, 557. The whole point of the matter at bar is that on March 1, 1913, respondent lessee-optionee had a property interest in the 1,000 acres of land.

3. Petitioner is mistaken in saying that the court below *relied* upon the decision in *Smith* v. *Bangham,* 156 Cal. 359. The court below merely notes that case in the course of discussion in the opinion (R. 343), and adopts an independent view in deciding the date of acquisition of the 1,000 acres, with respect to the statutory language "property acquired before March 1, 1913," as constitutionally interpreted. The principal case of *Richardson* v. *Hardwick,* 106 U. S. 252, cited and quoted by petitioner, is not helpful, being merely a clear illustration of the simplest of all situations, that in which an optionee has never acquired any interest in the land. There a bare option to purchase during a period of two years was given by Hardwick to Richardson, and Richardson permitted the option period of two years to expire without exercising the option. Since the bare option was never exercised, obviously Richardson never at any time had any property interest in the land.

4. The question in the instant case does not have any national importance such as the petitioner attempts to suggest. In the last analysis, the case at bar really turns on the local land law of California, and within that local land law turns on its own special and controlling circumstances (R. 342). The facts are mainly unique, bearing as they do upon a particular arrangement made before March 1, 1913, looking to the easiest possible certainty of financing the transformation of desert and cactus land into orange grove, and it really borders on absurdity for the petitioner to sug-

gest that any decision in the case at bar "will create confusion in numerous tax cases." The probability, if there is any probability at all, that there will ever hereafter be any case resembling the one at bar, is extremely remote. Moreover, no general doctrine of "relation back" is applied or present in the decision of the court below; the option was exercised in 1916, *i. e.*, four years *before* the incidence of the earliest tax (year 1920) involved; and the lease-option was entered into, possession of the land taken, an ample supply of underground water developed, the land set out to orchard, and at least $150,000 expended in capital improvements, *before* the Sixteenth Amendment was even proposed by the Congress to the legislatures of the several states. Compare *Eldredge* v. *U. S.*, 31 Fed. (2d) 924 (C. C. A. 6), and *Commissioner* v. *Pittsburgh Union Stock Yards Company*, 46 Fed. (2d) 646 (C. C. A. 3), in each of which cases an option had been given, possession taken by the optionee, and thousands of dollars expended by the optionee in capital development, and certainty of later exercise of the option established, all of these occurring before March 1, 1913, and being followed by formal exercise of the option subsequent to March 1, 1913. In one of these cases the *res* was a mine and in the other a union stock yard. In both instances it was held that the optionee had acquired a property in the land before March 1, 1913. Neither of these decisions "relating back" the date of acquisition of property to the date of true acquisition before March 1, 1913, has created any national confusion of tax law, and both of them are in accord with the doctrine of "practical ownership" laid down locally in *Laffan* v. *Naglee*, 9 Cal. 663 (*662), wherein a lease-option of a town lot in San Francisco for a term of eight years was made early in the year 1847, followed by the world-famous gold discovery of 1848, and rush of 1849, with a consequent increase in value of the land so great as to make exercise of the purchase-option a certainty.

Conclusion.

There is no real conflict between the decision of the court below and the decisions of other circuits; neither does this case present a question of general interest, since it is based primarily upon California law and the decision of the court below is consistent with the decisions of the State courts.

WHEREFORE, it is respectfully submitted that the petition for certiorari should be denied.

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September, 1935.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1935

No. 379.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY, *Respondent.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR THE RESPONDENT.

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(a) The respondent had an interest in land, by virtue of the option covenant being a covenant real, contained in a lease, under which respondent was in full, lawful and beneficial possession at March 1, 1913 12-13

(b) The respondent had an interest in land, by virtue of being an optionee in possession, who had expended a large sum of money in development and improvement of the land 13-15

(c) San Joaquin Fruit Company owned the land at March 1, 1913, under the doctrine of relation back 15-17

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II. If respondent did not acquire the property before March 1, 1913, then there was a conversion of capital assets on November 30, 1916, and respondent would be entitled to value of the land and improvements at the latter date as a basis for determining profit on sales 20-21

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*

v.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY, *Respondent.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The case was before the Board of Tax Appeals (16 B. T. A. 1290) when the merits were not considered but certain preliminary questions were decided. The Commissioner appealed to the Circuit Court of Appeals, Ninth Circuit, *Burnet* v. *San Joaquin Fruit & Investment Co.*, 52 F. (2d) 123, where the decision of the Board was affirmed in part and reversed in part. Thereafter a hearing on the merits was had before the Board of Tax Appeals, and the opinion

of the Board (R. 253-279) is reported in 28 B. T. A. 395; and on the taxpayer's appeal to the Circuit Court of Appeals, Ninth Circuit, the decision of the Board was reversed, *San Joaquin Fruit & Investment Co.* v. *Commissioner* (R. 338-344), reported in 77 F. (2d) 723.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered May 20, 1935 (R. 344). Petition for certiorari was filed on August 19, 1935, and was granted on October 14, 1935. The jurisdiction of this Court comes from Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED.

1. In 1906, respondent became lessee-optionee under a lease of 1,000 acres of bare land for a term of ten years, with option to purchase exercisable at the end of the term in 1916. Respondent entered into possession in 1906, promptly succeeded in developing an ample supply of underground water for irrigation, and before March 1, 1913, had developed the whole of the 1,000 acres into orange and walnut orchard. The value at March 1, 1913, was many times the option price, and it was then certain that the option would be (and it was) punctually exercised in 1916. For the purpose of determining gains on sales of the orchard after 1916 by respondent, was there an acquisition of "property" before March 1, 1913, so that the fair market value as of that date may be used as respondent's basis?

2. Alternatively, if a negative answer should be given to the foregoing, then was there a conversion of capital assets into a new form with essentially different characteristics when the extremely valuable option was converted into a fee simple in 1916, so that the fair market value of the fee simple when acquired on that date may be used as the basis of determining gains on resales at later dates?

STATUTES INVOLVED.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060:

Basis for determining gain or loss.

Sec. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *

* * * * * * * * *

Revenue Act of 1921, c. 136, 42 Stat. 227, 229:

Basis for determining gain or loss.

Sec. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; * * *

* * * * * * * * *

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

* * * * * * * * *

Revenue Act of 1924, c. 234, 43 Stat. 253, 258:

Basis for determining gain or loss, depletion, and depreciation.

Sec. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *

* * * * * * * * * *

(b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * * or (B) the fair market value of such property as of March 1, 1913, whichever is greater. * * *

* * * * * * * * * *

STATEMENT.

In 1906, the 1000 acres in question were bare and unirrigated land, overgrown with sagebrush and cactus (R. 340), and was part of a holding of approximately 100,000 acres owned by Irvine Company, a corporation, all of the stock of which, excepting some qualifying shares, was throughout 1906 (and continuously thereafter until 1920) owned by James Irvine, who dominated and controlled said corporation (R. 261).

In 1906, Sherman Stevens and C. E. Utt, experienced agriculturalists and orchardists, negotiated with James Irvine for the purchase of said 1000 acres from the latter, for the purpose of developing it into orchard (R. 297). The land was carefully selected out of said holding of 100,000 acres, and was well adapted for development into a citrus grove, and needed only the development of sufficient water for irrigation (R. 316). There was no known water supply within or upon said 1000 acres, but there was a known, partially developed artesian supply of unknown quantity about two miles distant upon the ten-acre tract hereinafter referred to (R. 314, 340). For the development of a citrus orchard, one flowing inch (a stream of twelve gallons a minute) of water is sufficient for four acres of orchard, or 250 flowing inches for 1000 acres (R. 311, 315). All other factors of success were present, and the development

of sufficient water would make certain the successful commercial improvement of said 1000 acres into orchard (R. 299).

Sherman Stevens and C. E. Utt at that time had cash capital of approximately $30,000.00 each, which they desired to use in capital expenditures in water development and in improvement of the said 1000 acres, without application of any part thereof upon purchase price of the land. James Irvine desired to have that amount of cash capital increased through a pro rata contribution by himself, in order to be certain of the improvement of the 1000 acres of land into orchard if sufficient water should be developed therefor (R. 299, 300).

Accordingly, the negotiations resulted in: (1) the organization on October 5, 1906, of a California corporation named San Joaquin Fruit Company, with a capital stock of $100,000.00, divided into 1000 shares of the par value of $100.00 each, of which 810 shares were issued to James Irvine, Sherman Stevens and C. E. Utt, for $81,000.00 cash paid in, at the rate of $27,000.00 each; and (2) thereupon a lease of said 1000 acres to San Joaquin Fruit Company for a term of ten years beginning December 1, 1906, and ending November 30, 1916, was caused by James Irvine to be made by Irvine Company (R. 261).

Thereunder, San Joaquin Fruit Company was required to set out and plant the whole of said 1000 acres to orchard, within four years from October, 1906; and to enter upon a ten-acre tract of water-bearing land about two miles distant from said 1000 acres, and sink wells for water and develop water to a volume of 250 flowing inches, and conduct it by pipe line to said 1000 acres, and to irrigate the orchard thereon; and to raise crops of grain, beans, peanuts or other products on such portions of the land as could be cultivated without material injury to the trees. And, as a part of said lease and of the consideration thereof, Irvine Company granted to San Joaquin Fruit Company an irrevocable option, exercisable on November 30, 1916, to buy

said 1000 acres at a price of $200.00 an acre, or a total of $200,000.00 for the whole (R. 261-262).

By the summer of 1907, several wells had been drilled by the lessee-optionee, San Joaquin Fruit Company, to depths of 300 to 400 feet on said ten-acre tract, a pipe line therefrom to said 1000 acres had been installed, and water was running to the highest elevation of said 1000 acres, and within two years from October, 1906, the full 250 flowing inches of water in a continuous and certain supply had been fully developed and the whole of said 1000 acres placed under full and adequate irrigation (R. 314-315) and the success of the whole project, and the exercise of said option, had become certain and were known and intended by all of the parties to be certain (R. 317, 310). The soil is a very deep, rich, alluvial soil, and said 1000 acres rank, and on March 1, 1913, ranked, among the finest in California for successful commercial production of oranges, lemons and walnuts. By March 1, 1913, said 1000 acres were fully improved with 390 acres of orange trees (140 acres 6-year old, and 250 acres 4-year old), and 600 acres of walnut trees (500 acres 6-year old, and 100 acres 4-year old) (R. 262), thereby greatly enhancing the value of the property (R. 340).

Within four years after October, 1906, San Joaquin Fruit Company had made a capital investment of $150,000.00 to $170,000.00 in developing and improving said 1000 acres, with an adequate and complete water system, wells, pumps, pipe line, irrigating system, trees, buildings, equipment, and the like (R. 340). Throughout the period of ten years ending November 30 1916, Sherman Stevens and C. E. Utt gave the whole of their personal time and labor to the project (R. 317), Stevens and Utt each drawing only $100.00 a month cash, and Irvine nothing (R. 317).

On March 1, 1913, the value of the land was $1,635,000.00, and the value of the option was $1,360,000.00; on November 30, 1916, the value of the land was $2,150,000.00, and the value of the option was $1,950,000.00 (R. 340).

The growth of value by March 1, 1913, was due primarily to (1) the full development of an adequate supply of water for irrigation, and (2) the proving and developing of said 1000 acres as successful citrus and nut land, and (3) the provision of adequate financing of the project, and (4) the experience, ability, energy and creative work of Sherman Stevens and C. E. Utt (R. 315-317).

Said option was punctually and fully exercised on November 30, 1916, and the purchase price of $200,000.00 was paid and legal title to the land was transferred to the San Joaquin Fruit Company (R. 318).

In 1922, the San Joaquin Fruit Company was reorganized as the San Joaquin Fruit and Investment Company, the respondent, and all of the property was transferred to it. The basis of respondent is the same as that of San Joaquin Fruit Company (R. 262-264; 273-274).

During the years 1920 to 1928, respondent sold various tracts of the property. In considering respondent's tax liability for these years, the Commissioner determined that the property was acquired by the San Joaquin Fruit Company on November 30, 1916, when the option was exercised, and that the cost was the $200,000.00 paid at that time for the land, plus the amounts paid for improvements under the lease agreement, and that this cost figure was the basis for ascertaining gain or loss (R. 338). The Commissioner's cost figure was not disputed (R. 275).

The Board of Tax Appeals approved the Commissioner's determination. The Circuit Court of Appeals reversed the decision of the Board, holding that the basis for determining gain or loss was the March 1, 1913, value of the property.

SUMMARY OF THE ARGUMENT.

The lessee-optionee acquired a property in the land, an interest real, before March 1, 1913, and therefore the fair market value on that date is the proper basis in determining gains on sales of the lands thereafter. The lan-

guage of the Revenue Acts is "property acquired before March 1, 1913," and the persistent error of the Commissioner has been in his attempt to read "property" as though it read "fee simple," or "legal title." The word "property" is not to be given such a narrow or technical meaning as is sought by the Commissioner. The cases relied upon by him are merely cases where an option was never exercised, or where, until exercised, the optionee was no more than a bare optionee out of possession.

The option at bar is far more than a bare option. (1) It was contained in a lease, (2) the lessee-optionee was in full, lawful and beneficial possession, (3) the lessee-optionee had expended $150,000.00 to $170,000.00 in developments and improvements by the close of 1910, or long before March 1, 1913, (4) by developing ample and continuous water, the lessee-optionee had transformed 1000 acres of desert into 1000 acres of fine citrus and nut groves, (5) long before March 1, 1913, it was certain that the lessee-optionee would exercise the option, (6) the lessee-optionee did exercise it, punctually and fully, on the day, and (7) on March 1, 1913, the option was worth well over a million dollars, and was steadily increasing in value.

The distinctions of fact just stated are distinctions of high importance, and establish the acquisition of a property in the land before March 1, 1913, for the following reasons:

First, the option was connected with a lease, thus making the option irrevocable, and indivisible from the lease, and giving the option the character of an interest real.

Next, the optionee went into possession at the time the option was given and that possession was continuous from 1906 through 1913 and beyond, and by three or four years before 1913, the optionee had made great improvements of the land, expending from $150,000.00 to $170,000.00 in developing and improving the bare land into an orchard. The facts of possession and improvements created a property

interest in the land. The essence of an ownership is beneficial possession and in the present case this possession has been continuous ever since 1906. It may be perfectly true that a bare optionee, not in possession, does not "acquire" a property until he exercises the option; but in the case of an optionee who is put in beneficial possession when the option is given, "acquisition" occurs when possession commences, and thereafter when the option is exercised the optionee merely announces that he has chosen not to surrender something that he had "acquired" theretofore. Being in rightful possession, and not subject to ouster even by the paper title, the optionee in possession has a substantial title, and then when he exercises a choice not to give up possession a "perfect" title ripens.

Next, the reasoning of the Circuit Court of Appeals is perfectly sound with respect to the modified form of the doctrine of "relation back" applied by it, and this is particularly true in the present context, *i. e.*, when the relation back goes no further than the time when continuous beneficial possession and use commenced. An acquisition of property is not related back upon the facts at bar; all that is related back is the optionee's decision not to give up the land.

Next, by March 1, 1913, the optionee had become the economic owner, the practical owner, of the land. Years before 1913, an ample supply of underground water had been developed and the 1000 acres of sagebrush and cactus had been developed into an orchard and walnut grove, which, on March 1, 1913, had a value of $1,635,000.00, and for which the optionee would have to pay only $200,000.00 when the time for exercise of the option arrived. On March 1, 1913, it was certain that the option would be exercised. Upon such facts the law is clear that the optionee in possession must be deemed to be the practical owner, or economic owner, of the property in the land. This is emphasized by the fact that on March 1, 1913, *someone* owned the property; it could not be the optionor, because his title was *cum*

onere, burdened by the obligation to sell at $200,000.00; the difference of nearly one and a half million dollars was necessarily owned by the optionee, and that was so nearly the whole value that it must be self-evident that the optionee in possession was the economic owner of the property.

If none of the foregoing propositions be true, then it must follow, in the alternative, that on November 30, 1916 (when the option was exercised) the capital of the optionee was converted from one form into another form having essentially different characteristics, and therefore the value on that date would be the basis for determining gains on sales of lands thereafter.

ARGUMENT.

I.

There Was an Acquisition of Property in the Land, an Interest Real, Before March 1, 1913, so that the Fair Market Value as of that Date is the Proper Basis in Determining Gains on Sales of the Land.

The language of the Revenue Acts is "property acquired before March 1, 1913." The term used is not "fee simple," nor is it "legal title"; the word is "property." There "is nothing to suggest that the word 'property' is used in any restricted sense," *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, 369, and it "should not be given a narrow or technical meaning," *Commissioner* v. *Stephens-Adamson Mfg. Co.*, 51 F. (2d) 681, 682. The "term 'property,' as applied to lands, comprehends every species of title, inchoate or complete, and embraces rights which lie in contract, executory as well as executed," *Bryan* v. *Kennett*, 113 U. S. 179, 192; *Falk v. Commissioner*, 64 F. (2d) 171, 172. In the term, "all titles are embraced, legal or equitable, perfect or imperfect," *Bryan* v. *Kennett, supra* (113 U. S., at 192).

In his petition to this Court, and in his brief in the Circuit Court of Appeals, the Commissioner has persistently used the term "property" as a synonym of "fee simple"

or "legal title" or "complete and perfect title." The Commissioner's argument has been that, until exercise of option, an optionee of land is neither legal nor equitable owner of an interest in the "property." Of the cases heretofore cited by the Commissioner, some were cases of a bare optionee out of possession who never exercised his option,

Richardson v. *Hardwick*, 106 U. S. 252,
Phenix Ins. Co. v. *Kerr*, 129 Fed. 723;

in another there were merely some obiter remarks arguendo,

Todd v. *Citizens' Gas Co.*, 46 F. (2d) 855, 866;

in two of the cases there was merely a bare optionee of stock rights,

Commissioner v. *Cummings*, 77 F. (2d) 670,
Chisholm v. *Commissioner*, 79 F. (2d) 14;

and finally, in

Lucas v. *North Texas Lumber Co.*, 281 U. S. 11,

we find merely a bare optionee out of possession, without more.

In the case at bar, the situation differs greatly, in many ways.

Respondent did not have a mere option, or bare option. (1) Respondent's option was contained in a lease, (2) respondent was in full, lawful and beneficial possession, (3) it had expended $150,000.00 to $170,000.00 in developments and improvements by the close of 1910, or long before March 1, 1913, (4) by developing ample and continuous water, it had transformed 1000 acres of desert into 1000 acres of fine citrus and nut groves, (5) long before March 1, 1913, it was certain that it would exercise the option, (6) it did exercise it, punctually and fully, on the day,

(7) on March 1, 1913, respondent's option was worth well over a million dollars, and was steadily increasing in value.

We therefore turn to a presentation of the effect of those differences, in establishing in respondent a *property* in the land on and before March 1, 1913:

(a) *Respondent had an interest in land, by virtue of the option covenant being a covenant real, contained in a lease, under which respondent was in full, lawful and beneficial possession at March 1, 1913.*

The California case of *Ludy* v. *Zumwalt*, 85 Cal. App. 119, cited in the opinion of the Board (R. 268), is not in point; moreover, it was fully explained and distinguished by the Supreme Court of California in the case of

> *Chapman* v. *Great Western Gypsum Co.*, 216 Cal. 420, 14 Pac. (2d) 758, 85 A. L. R. 917,

which latter case demonstrates that by the law of California, from the earliest day, an option covenant *contained in a lease* is a covenant real, *i. e., real property.* The Court expressly distinguishes the cases of options "*unconnected* with an interest in property, such as a *lease*," and fully and expressly distinguishes *Ludy* v. *Zumwalt, supra,* saying that "whatever was said in [*Ludy* v. *Zumwalt*] as to the nature of an option unconnected with a lease or other interest in land can have no application to a case where the option is so connected."

The lease and option are indivisible; an option contained in a lease is irrevocable and is not severable. As said by the Supreme Court of California in *Gordon* v. *Dufresne*, 205 Cal. 512:

> "The question of the divisibility of lease and option agreements of the type here presented has been before this court many times, and it has been many times decided that such agreements are not severable, but that, on the contrary, the lease and option form one document, the provisions of which are interdependent,

> and the covenant to pay rent or do other acts supports the option as well as the right to occupy the premises. Prichard v. Kimball, 190 Cal. 757, 214 P. 863; Cates v. McNeil, 169 Cal. 697, 147 P. 944; Hall v. Center, 40 Cal. 63; De Rutte v. Muldrow, 16 Cal. 505; 35 Corpus Juris, pp. 1038, 1039."

Our entry on the land in 1906 was not merely as lessee; it was an entry as lessee-optionee, and the possession taken by respondent in that year has been continuous, rightful and undisturbed ever since.

(b) *Respondent had an interest in land, by virtue of being an optionee in possession, who had expended a large sum of money in development and improvement of the land.*

The case of *Crowell* v. *Ewing,* 4 Cal. App. 358, 88 Pac. 285, was a case of an optionee in *possession* of mining property, who had made $20,000.00 *improvements,* and it was held that possession and improvements, coupled with the option, gave him "an actual interest" in the land.

At bar, respondent had been in possession continuously from 1906 through 1913 and beyond, and within two years after 1906 respondent developed the required amount of water for irrigation purposes and by the close of 1910 expended from $150,000.00 to $170,000.00 in developing and improving the tract (R. 262).

The case of *Crowell* v. *Ewing, supra,* finds strong support in *Bryan* v. *Kennett, supra* (113 U. S. 179), where "taking possession of the land and improving it" (113 U. S. 191) was held to create a property in the land; this Court said that it was not necessary to "define the precise nature and extent of the interest acquired by Austin in this land," it being sufficient that he had a property in the land. It is unnecessary to the ownership of an interest in real property that the owner of the interest be able to give a name to the interest, or assign it to any particular pigeon-

hole, but the *substance* is looked to, *Estate of Pitts*, 218 Cal. 184, 191.

> "Possession has always been a means of acquiring title to property. It was the earliest mode recognized by mankind of the appropriation of anything tangible by one person to his own use, to the exclusion of others, and legislators and publicists have always acknowledged its efficacy in confirming or creating title."
>
> *Campbell* v. *Holt*, 115 U. S. 620, 623.

The very substance of property in land is *possession;* "title" is merely a means to possession.

> " 'Title' is defined as the means whereby the owner of lands hath the just possession of his property."
>
> 2 *Bl. Comm.* 195;
>
> *Arrington* v. *Liscom*, 34 Cal. 365, at 385.

In 1906, respondent acquired a rightful possession, good against the world, even against the optionor, and it was entirely a matter of its own *choice* (option) whether it would ever give up possession. It was not a matter of choosing to *acquire* possession; it was, conversely, a matter of choosing whether respondent would give it up. Respondent had "a substantial title," and when it chose not to give up possession, a "perfect" title ripened.

> "The party who has acquired an absolute right of possession, which will not only shield him in his possession against the attacks of all the world, but, when ousted, will restore him to, and protect him in, his just possession, even against the party having the written title, would seem to have a substantial title."
>
> *Arrington* v. *Liscom, supra* (34 Cal., at 385).

> "Possession has all but swallowed up ownership; and the rights of a possessor, or one entitled to possess, have all but monopolized the very name of property."
>
> *Webbs' Pollock on Torts*, 417;
>
> 1 *Jones' Bl. Comm.* 973-978, note, "Nature of Possession," by Pollock.

The Civil Code of California, section 654, defines the ownership of a thing as "the right of one or more persons to *possess and use* it to the exclusion of others." That literally describes the right of respondent, from 1906 continuously onward. Clearly, respondent had a property in the land on March 1, 1913.

(c) *San Joaquin Fruit Co. owned the land at March 1, 1913, under the doctrine of relation back.*

The earliest tax year involved in the cases at bar is the tax year 1920. Long before then, the ownership of the San Joaquin Fruit Co. had been *related back* to the year 1906, so that (with respect to all tax years here involved) San Joaquin Fruit Co. was the owner of the 1000 acres as at March 1, 1913. In considering a land optionee's interest in California, two situations plainly distinguish: (1) Non-exercise of the option, the result of which is that the optionee is deemed never to have had any interest in the land; (2) *Exercise* of the option, the result of which is that *an equitable interest in the land* is related back to the day the option was given:

Smith v. *Bangham,* 156 Cal. 359, 365 (104 Pac. 689, 28 L. R. A. N. S. 522);
Crowley v. *Byrne,* 71 Wash. 444, 129 Pac. 113;
Horgan v. *Russell,* 24 N. D. 490, 140 N. W. 99, 43 L. R. A. N. S. 1150;
People's Street Ry. Co. v. *Spencer,* 156 Pa. 85, 27 Atl. 113, 36 Am. St. Rep. 22;
Kerr v. *Day,* 14 Pa. 112, 53 Am. Dec. 526.

When a lessee exercises an option to purchase, he is to be considered as the owner *ab initio.* (*People's Street Ry. Co.* v. *Spencer, supra,* at 27 Atl. 114, col. 2.)

Only a superior, intervening *equity* prevents the relation back, *e. g.,* a purchase-money lien:

Shay v. *McNamara,* 54 Cal. 169;
Hawkins v. *Harlan,* 68 Cal. 236, 9 Pac. 108;
Ludy v. *Zumwalt,* 85 Cal. App. 119, 259 Pac. 52.

That is, when a superior, intervening equity exists, the doctrine of relation back is not applied, and the optionee is deemed not to have had an interest in the land until the day of acceptance. In the case at bar, however, the option was exercised in 1916, which was years *before* the incidence of the tax for the earliest tax year, 1920. Plainly, therefore, in determining taxes for 1920 and later years, respondent is deemed to have had at least an equitable interest in the land from 1906 onward. The incidence of the tax having been *after* the exercise of option, the United States has no superior intervening right.

The Circuit Court of Appeals took the following ground in its opinion (R. 343-344):

> "It is clear that so far as the rights of the seller and purchaser are concerned the contract resulting from the exercise of the option does relate back to the giving of the option. It is because of the binding offer from the optioner that the optionee is entitled to purchase the property at a fixed price at the time the option is exercised. The two contracts, the giving of the option and the contract of sale resulting from its exercise, are in effect parts of a single transaction differing from a completed sale in that the optionee is entitled to refrain from entering into the contemplated agreement of sale if he so desires. From the standpoint of the income tax laws the rights of the optionee, upon the exercise of the option, should be related back to the date the option was given and the resulting contract treated as having been made on that date. We conclude then that the optionee and lessee 'acquired' the land within the meaning of the income tax laws as of the time the option was given and that the taxable gain resulting from subsequent sales of a portion of the land should be determined by deducting from the selling price the value as of March 1, 1913 of the land sold."

Great strength is added to the foregoing reasoning when it is kept in mind that the Court was speaking to a context wherein *possession and use* were given to the optionee in 1906 when the irrevocable option was given. In considering

the doctrine of "relation back," we need not inquire whether the doctrine applies in the case of exercise of an option by an optionee *out of possession.* We have here continuous possession, use, and capital development and improvement continuously from the time that the option was given. Granting that in many situations the application of the doctrine of relation back is the application of a fiction, there is nothing fictitious about continuous possession, use, development and improvement. An *acquisition* of property is not related back upon the facts at bar; all that is related back is the optionee's decision not to *give up* the land.

(d) *On March 1, 1913, San Joaquin Fruit Co. was the economic owner, the practical owner, of the land.*

Full development of 250 inches, and more, of water was reached in about two years from October, 1906 (R. 314-315). By March 1, 1913, the thousand acres were fully improved with 390 acres of four and six year old orange trees, and 600 acres of walnut trees of similar age. On March 1, 1913, the developed and improved grove had a value of $1,635,000.00, and continued to increase in value until the option was exercised on November 30, 1916, when the value was $2,150,000.00 (R. 340). The option price was only $200,000.00. On March 1, 1913, it was certain that the option would be exercised (R. 310-311; 316-317).

The doctrine of "practical ownership" was applied by the Supreme Court of California in a case not nearly as strong as ours upon the facts. In the case of *Laffan* v. *Naglee,* 9 Cal. 663 (*662), a lease of a lot in San Francisco, for a term of eight years, with an option to buy, was made early in the year 1847. Then came the gold discovery of 1848, followed by the world famous "gold rush" of 1849, with consequent great increase in value of the lot, so great as to make exercise of the purchase-option a certainty; and under such circumstances, the Supreme Court of California

treated the lessee-optionee as the *practical owner* of the lot. As said by the Court, the circumstances were such that, in the nature of things, a sale would be *compelled* at a very low price, rendering the option so valuable that it was impossible to disregard it. (See 9 Cal. at *676.) In other words, the circumstances were such that it could be predicted with substantial certainty that the option would be exercised.

It was held in the Third Circuit, in

Commissioner v. *Pittsburgh Union Stock Yards Co.*, 46 F. (2d) 646,

that when in fact a valuable option existing on March 1, 1913, was exercised thereafter, and there was testimony that "on March 1, 1913, there was absolutely no doubt" that the option would be exercised, it would be treated as though it were exercised on March 1, 1913. That case has since been acted upon by the Government as authority for the doctrine of "prediction with substantial certainty," as will appear from *379 Madison Ave., Inc.* v. *Commissioner*, 60 F. (2d) 68, 70, col. 1. In the case at bar, at March 1, 1913, it certainly could have been, and was, predicted with certainty that the option would be exercised when the day for exercise arrived.

It was held in the Sixth Circuit, in the case of

Eldredge v. *U. S.*, 31 F. (2d) 924,

that an option on mining ground given before March 1, 1913, which had reached high value on the latter date and was certain to be exercised thereafter, would be treated as though it were exercised.

In the foregoing cases cited from the Third and Sixth Circuits, the optionee was in possession, and had developed and improved the land to a value at March 1, 1913, so far in excess of the option price that he was treated as the practical owner, the economic owner, of the land at March 1, 1913.

It seems to us that those cases are in line with recent enunciations by this Court of the doctrine of economic ownership, "economic interest," *e. g.*, as in

Palmer v. *Bender*, 287 U. S. 551, 558.

It is clear that on March 1, 1913, respondent was the economic owner of the land, then of a value of $1,635,000.00, with a purchase price of only $200,000.00. The value of the land was not available to the optionor, at March 1, 1913, because his legal title could not be then valued at more than $200,000.00, for the reason that his tile was *cum onere*, burdened by the $200,000.00 option, *Wilson* v. *Bowers*, 51 F. (2d) 261. Can it be that on March 1, 1913, *no one* owned property amounting to the difference between $200,000.00 and $1,635,000.00? Surely, from every viewpoint, respondent was the practical and economic owner of the property. We adopt the reasoning of the Circuit Court of Appeals upon the impossibility of reaching any different view, consistently with the Constitution (R. 341).

If the optionee had sold its option after March 1, 1913, but before exercise in 1916, it would have been entitled to use as a basis for determining the gain on such sale, the value of the option on March 1, 1913, and only the small difference would have been taxable, *i. e.*, the increase in value of the option after March 1, 1913. If the purchaser of the option had paid for it, for example, $1,400,000.00, and then had exercised the option, its basis for the properties would have been not only the $200,000.00 actually paid to the optionor, but also the $1,400,000.00 previously paid for the option, or a total of $1,600,000.00. This shows clearly that if the exercise of an option is not a realizing and taxable transaction the basis for the property acquired under the option is the sum total of the following: (a) The amount paid to the owner of the land at the time of the exercise of the option, to-wit, $200,000.00; and (b) the cost or other basis of the option itself. In the case of the purchaser, referred to above, such cost would be $1,400,000.00. In our

case it would be the cost or March 1, 1913 value, whichever was higher. Since the March 1, 1913, value of the option was approximately $1,360,000.00, that should be substituted as the basis for the option. What has the taxpayer done to forfeit that value as of March 1, 1913?

II.

If Respondent Did Not Acquire the Property Before March 1, 1913, Then There Was a Conversion of Capital Assets on November 30, 1916, and Respondent Would Be Entitled to the Value of the Land and Improvements at the Latter Date as a Basis for Determining Profit on Sales.

Because of the conclusion it reached that the property was acquired before March 1, 1913, the Circuit Court of Appeals said (R. 344):

> "The conclusion we have reached as to the effect of the exercise of the option also disposes of petitioner's contention that the transaction on November 30, 1916 resulted in an exchange of capital assets and renders further discussion of that contention unnecessary."

Consequently, our assignments of error 4 and 5 (R. 284), remain to be decided if this Court should rule that the property was not acquired before March 1, 1913. The assignments of error were fully argued in our brief in the Circuit Court of Appeals, at pages 23-27. In substance, the argument is that if the property was acquired *after* March 1, 1913, *i. e.*, when the option was exercised on November 30, 1916, then there was a *conversion of capital* on the latter date, *i. e.*, capital assets consisting of (1) an absolute vested property right, a highly valuable option, and (2) purchase money. The conversion was into the legal fee simple absolute of the 1000 acre grove, of the value of $2,150,000.00. Plainly, the new asset, the converted form, had "essentially different characteristics" (*Marr* v. *U. S.*, 268 U. S., 536,

540) than had the old assets, and there was a "conversion of capital."

It follows that there was a closed transaction, and therefore that the basis of the property for the subsequent years at bar (1920 and later years) is the value of the land and improvements on November 30, 1916.

Respectfully,

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Supreme Court of the United States

OCTOBER TERM, 1935.

No. 379.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY, *Respondent.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

PETITION FOR MODIFICATION OF CONCLUSION.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 379.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY, *Respondent.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

PETITION FOR MODIFICATION OF CONCLUSION.

Respondent prays that the conclusion of a general reversal ordered in the judgment rendered on March 2, 1936, be modified in the following respect:

We bow to the unanimous opinion of the Court as to the points ruled upon. However, there is in the record at page 284 an assignment of error, number 6, reading as follows:

> "(6) The Board of Tax Appeals erred in deciding that the value of the land and improvements at Novem-

ber 30, 1916, was not the basis of the property for the years involved, for purposes of invested capital."

The "years involved," as to *invested capital* are 1920 and 1921, and the relevant portions of the petitions for those years are at pages 66 (year 1920) and 103 (year 1921). The allegation at page 66 is typical, and reads as follows:

> "(1) That the Commissioner failed and refused to permit the San Joaquin Fruit Company to include in its invested capital for the calendar year 1920 the sum of $1,659,372.85, which represents the disallowance of surplus arising from a closed transaction which occurred on November 30, 1916, on which date the San Joaquin Fruit Company exercised an option to acquire certain improved real estate, which option had been acquired on October 13, 1906, and had steadily and continuously increased in value through the ten-year period and on the date of its exercise had a market value of $1,659,372.85."

The Circuit Court of Appeals did not rule upon the assignment of error, apparently because it ruled in our favor upon another ground. The assignment of error is not yet ruled upon. The question raised by the assignment is whether the land, having been acquired (as this Court has now held) in 1916, in part as the result of ten years of effort and work, the value of the land as of 1916 became part of the *earned surplus and undivided profits* for the years *subsequent* to 1916. Under section 326(a)(3) of the Revenue Act of 1918, 40 Stat. (Ch. 18) 1057, 1092, earned surplus and undivided profits are included in the statutory term "invested capital." There is not involved a mere book write-up, as in *La Belle Iron Works* v. *U. S.*, 256 U. S. 377, but the actual occurrence of a real event, *i. e.*, an acquisition on November 30, 1916, of land by way of final realization of ten years of effort and work, when an option of very high value was merged into the fee of the land.

We should have a ruling on the assignment of error (*Maryland Casualty Co.* v. *Jones*, 279 U. S. 792, 796-797), and therefore respectfully petition either that there be a direction to the Court below to rule upon it, or that this Court rule upon it.

Respectfully,

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SUPREME COURT OF THE UNITED STATES.

No. 379.—October Term, 1935.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. San Joaquin Fruit & Investment Company. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[March 2, 1936]

Mr. Justice Roberts delivered the opinion of the Court.

Is real property "acquired", within the meaning of the revenue acts, when a lease is made containing an option to purchase, or when the option is exercised? The question is presented under the relevant sections of the Revenue Acts of 1921, 1924, 1926 and 1928.[1]

October 13, 1906, the Irvine Company leased to the San Joaquin Fruit Company one thousand acres, part of a much larger tract, of bare unirrigated land in California. The lessor was wholly owned by one Irvine, and the lessee was organized by two experienced men who together with Irvine subscribed its capital, in the hope that planting, irrigation, and cultivation would make the land valuable. The lease was for a term of ten years from December 1, 1906; required the lessee to plant the tract as an orchard within four years, to procure and conduct a specified supply of irrigation water to the tract, and to raise certain field crops in connection with the orchard; and embodied an irrevocable option to buy the whole acreage for $200,000, exercisable November 30, 1916. Before October, 1908, the lessee procured the water, planted, and was suc-

[1] 42 Stat. 227, 229; 43 Stat. 253, 258; 44 Stat. 9, 14; 45 Stat. 791, 818. The provisions of the Revenue Act of 1924, which are typical, follow:

"Sec. 204. (a). The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that . . .

"(b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property . . . or (B) the fair market value of such property as of March 1, 1913, whichever is greater . . .".

Section 202 of the Revenue Act of 1921 speaks of "property, real, personal, or mixed."

cessfully working the land; and the taking up of the option at the end of the term was then no longer a matter of doubt. By February 28, 1913, the value of the property had greatly increased. On November 30, 1916, the option was closed and conveyance made to the lessee, which subsequently transferred the land to the respondent under circumstances which do not alter the basis for calculation of gain. During the period 1920 to 1928, inclusive, the respondent sold portions of the tract. In computing the tax liability for these years the petitioner determined the property was acquired November 30, 1916, when the option was exercised, and its cost was the $200,000 paid plus the amounts expended for improvements pursuant to the lease. The respondent appealed to the Board of Tax Appeals, contending the lessee acquired a property in the land,—an interest real,—prior to March 1, 1913, and the value of the land at that date was the proper basis for calculating gain on sales. The Board sustained the petitioner.[2] The Circuit Court of Appeals reversed the Board's decision.[3] To resolve an asserted conflict[4] we granted certiorari.

We hold that the respondent acquired the property on November 30, 1916. The option itself was property, and doubtless was valuable. If it had been assignable, and the lessee had sold it at a profit, taxable gain would have resulted from the sale. But the option is admittedly not the same property as the land. So conceding, the respondent still insists that ownership of the option created an interest in the land. This would not be true of a bare option unconnected with a lease;[5] but we are told that because embodied in the lease the agreement became a covenant real and gave the lessee a species of interest or property in the land. The weight of authority is to the contrary,[6] and no cited California decision supports the position.[7] But even if we should agree that a lessee-optionee acquires, by virtue of the instrument, an equitable

[2] 28 B. T. A. 395.

[3] 77 F. (2d) 723.

[4] See *Commissioner* v. *Cummings*, 77 F. (2d) 670; *Chisholm v. Commissioner*, 79 F. (2d) 14.

[5] *Richardson* v. *Hardwick*, 106 U. S. 252, 254; *Todd* v. *Citizens Gas Co.*, 46 F. (2d) 855, 866.

[6] *Willard* v. *Tayloe*, 8 Wall. 557, 564; *Kadish* v. *Lyon*, 229 Ill. 35, 40; *Pras* v. *Sheffield*, 49 Kan. 702, 710; *Caldwell* v. *Frazier*, 65 Kan. 24; *Luigart* v. *Lexington Turf Club*, 130 Ky. 473, 480; *Trumbull* v. *Bombard*, 171 App. Div. (N. Y.) 700; *Gamble* v. *Garlock*, 116 Minn. 59.

[7] Compare *Ludy* v. *Zumwalt*, 85 Cal. App. 119; *Hicks* v. *Christeson*, 174 Cal. 712.

interest in the land it would not follow that, within the contemplation of the revenue acts, he acquires the property at the date of the option rather than at the date of conveyance. The word "acquired" is not a term of art in the law of property but one in common use. The plain import of the word is "obtained as one's own". Language used in tax statutes should be read in the ordinary and natural sense.[8] In the common and usual meaning of the term the land was acquired when conveyed to the respondent's predecessor.

The Circuit Court of Appeals thought that to avoid serious doubts concerning the constitutional power to tax gains accruing before March 1, 1913, it was important, if possible, to treat the property as acquired when the option was given. The court therefore resorted to the doctrine that the title when acquired relates back to the date of the option. Cited in support of this application of the theory are cases in which the California courts have invoked it to subordinate the rights of assignees or mortgagees who became such with notice of an outstanding option.[9] The fiction of relation, indulged to defeat those dealing with the legal title with knowledge of the option, can give no aid in solving the question of the time of the optionee's acquirement of property under a statute taxing gain upon a subsequent sale. And there is no need of the fiction to avoid any constitutional question. The power to tax gains which accrued prior to the adoption of the Sixteenth Amendment is not here involved. We suppose the amount received by the respondent from a sale includes and is the result of increase in value of the property in the period prior to March 1, 1913. But the gain accruing in that period did not accrue to property owned by the lessee. Neither the land nor the gain so accruing before March 1, 1913, became the lessee's property until 1916 when it took up the option.

An alternative contention is that the exercise of the option and the conveyance on November 30, 1916, constituted merely an exchange of capital assets,—a closed transaction,—and the basis for calculation of gain was the value of the land and improvements at that date. The capital asset, sale of which resulted in taxable gain, was the land. This was not an asset of the taxpayer prior

[8] *Old Colony Railroad Co.* v. *Commissioner*, 284 U. S. 552; *Reinecke* v. *Smith*, 289 U. S. 172.

[9] *Smith* v. *Bangham*, 156 Cal. 359; *Chapman* v. *Great Western Gypsum Company*, 216 Cal. 420.

to the exercise of the option. We think it clear that there was no combination of two capital assets,—the option and $200,000 of cash, to form a new capital asset, the land, which was subsequently sold at a profit. The judgment of the Circuit Court of Appeals must be reversed.

So ordered.

A true copy.

Test:

Clerk, Supreme Court, U. S.

